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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1945

No. 263

E. L. LUSTGRAAF, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED JULY 28, 1945.

CERTIORARI GRANTED OCTOBER 8, 1945.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

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A. L. LUSTHAUS, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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[fol. 1]

IN THE TAX COURT OF THE UNITED STATES

Docket No. 112702

A. L. LUSTHAUS, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

1942

Oct. 10—Petition received and filed. Taxpayer notified. Fee paid.

Oct. 12—Copy of petition served on General Counsel.

Oct. 10—Request for Circuit hearing in Pittsburgh, Pennsylvania, filed by taxpayer. 10-12-42 Granted.

Nov. 18—Answer filed by General Counsel.

Nov. 21—Copy of answer served on taxpayer. Pittsburgh, Pa.

1943

July 27—Hearing set Sept. 20, 1943. Pittsburgh, Pa.

Aug. 13—Application for subpoena to A. L. Lusthaus and Lillian C. Lusthaus filed by General Counsel. Subpoenas (2) issued.

Aug. 13—Application for subpoena duces tecum to F. W. Ries, Jr., filed by General Counsel. 8-13-43 Subpoena issued.

Sept. 6—Application for subpoena duces tecum and subpoena issued to respondent for T. A. L'Estrange or proper person designate.

[fol. 2]

Sept. 22—Hearing had before Judge Smith on merits. Submitted. Appearance of Paul E. Hutchinson filed. Briefs due 11-1-43. Replies 11-24-43.

Oct. 4—Transcript of hearing 9-22-43 filed.

Oct. 22—Joint motion for extension of 30 days to file briefs filed. 10-23-43 Granted.

Nov. 30—Brief filed by taxpayer.

Dec. 1—Motion for extension to Dec. 15, 1943 to file brief filed by General Counsel. 12-2-43 Granted.

Dec. 15—Brief filed by General Counsel. Served 12-16-43.

Dec. 16—Copy of brief served on General Counsel.

1944

Jan. 10—Reply brief filed by taxpayer. 1-10-44 Copy served.

Mar. 29—Findings of fact and opinion rendered, Smith, Judge, Decision will be entered for respondent. Copies served.

Mar. 29—Decision entered, Smith, Judge, Div. 5.

Apr. 20—Order correcting report entered 3-29-44. Smith, Judge.

May 12—Petition for review by U. S. Circuit Court of Appeals, 3rd Circuit, filed by taxpayer, 5-12-44—1 additional copy received.

May 15—Notice of filing petition for review sent to J. P. Wenchel filed.

May 16—Proof of service filed.

May 30—Designation of contents of record filed by taxpayer and proof of service thereon.

[fol. 3]

Jun. 19—Motion for extension of time to August 10, 1944 to prepare, transmit and deliver the record filed by taxpayer.

Jun. 19—Order extending time to August 10, 1944 to prepare, transmit and deliver the record entered.

IN THE TAX COURT OF THE UNITED STATES

Statement of Evidence

Federal Courtroom, Pittsburgh, Pa.
Sept. 22, 1943—10:10 a. m.

(Met pursuant to notice.)

Before Hon. Charles P. Smith, Judge.

APPEARANCES:

A. G. Wallerstedt, C. P. A., W. A. Seifert, Esq., William Wallace Booth, Esq., Joseph W. Ray, Jr., Esq., Paul E. Hutchinson, Esq., 747 Union Trust Building, Pittsburgh, Pa., appearing for the Petitioner.

W. J. McFarland, Esq., 2304 Clark Building, Pittsburgh, Pa., appearing for the Respondent.

[fol. 4] PROCEEDINGS

* * * Omission from Transcript pages 4, 5 and 6.

A. L. LUSTHAUS, 170 Stockton Avenue, Uniontown, Pennsylvania, the Petitioner, called as a witness in his own behalf, first being duly sworn, testified as follows:

The Court: Please give your name and address to the stenographer.

Mr. Lusthaus: A. L. Lusthaus, 170 Stockton Avenue, Uniontown, Pennsylvania.

Direct examination.

By Mr. Wallerstedt:

Q. Mr. Lusthaus, are you the taxpayer petitioner in this case?

A. Yes.

Q. What is your business?

A. I conduct two furniture stores in Uniontown, partnership with Mrs. Lusthaus.

Q. How long have you been in the furniture business, Mr. Lusthaus?

A. Since 1918.

Q. Since 1918?

A. Yes.

Q. Will you sort of detail your operations?

A. In 1918 I bought an interest in a corporation; in 1921 I purchased the balance of the stock from the other stockholders; in 1926 I combined with Cohen Furniture Company in Uniontown up to 1933, where we divided up and I took over the Household Furniture Company and I went in as a sole owner until 1940. In January, 1940, I sold half to my wife, Mrs. Lusthaus.

[fol. 5] Q. Mr. Lusthaus, when did you decide to offer your wife an interest in the partnership?

A. I'm sorry. Will you please repeat that.

The Court: The stenographer will read back the last question.

(The last question was read to Mr. Lusthaus.)

The Witness: Sometime during 1939.

By Mr. Wallerstedt:

Q. Will you please tell us what happened in the fall of 1939 or in 1939?

A. In 1939 my wife and I decided—I asked my wife to come in and buy a half interest in the store and she agreed to do so.

Q. She accepted your offer?

A. She accepted my offer; yes, sir.

Q. That was in the fall of 1939?

A. Yes.

Q. And when was this partnership started?

A. It started January, 1940.

Q. At the beginning of January?

A. At the beginning of January, 1940.

Q. Now, did you discuss the matter at all with your lawyer?

A. I did. I discussed it with Mr. Ray.

Q. Is Mr. Ray here in the courtroom?

A. Yes, sir.

Q. And when did that discussion take place with your lawyer?

A. Several times in 1939.

Q. What was the selling price between you and your wife as to the one-half interest of the partnership?

A. The selling price would be $105,000.

Q. And how did you arrive at that amount?

[fol. 6] A. I gave my wife a check, an outright gift of $55,000, and the balance of $50,000 I took back notes payable, $5,000 a year.

Q. Do you recall whether or not you were to take out any money at first?

A. It came at first to $230,000 so we agreed at first I should draw out $20,000 to make it an equalized $210,000.

Q. And when did you draw out this $20,000, if you remember?

A. In January, 1940; I believe it was the first week in January.

Q. Now, what instructions, if any, did you give to your lawyer in the fall of 1939?

A. I gave the instructions to my lawyer to draw up a partnership agreement and the partnership was to take effect as of January 1, 1940.

Q. And that was Mr. Ray, the attorney that is here?

A. Mr. Ray. I asked him to draw up the necessary papers which were required for the partnership.

Q. What was his answer to that?

A. He agreed. Mr. Ray agreed that he would do that.

Q. Well, now, did he draw up those papers?

A. No. Mr. Ray took sick in the latter part of 1939 and in the early part of January 1940, but Mr. Ray sent word to me that we can start our partnership and as soon as he gets back to the office he would fix up our books as of January 1, 1940.

Q. What happened to you and your wife at that time?

A. My wife and I went to Florida during the early part of March and we came back at the end of the month and got [fol. 7] in touch with Mr. Ray and Mr. Ray informed me that the papers were ready and to go right ahead.

Q. Then did you sign some partnership agreements; other papers that he had for you?

A. I did.

Q. In 1939 when you were discussing this partnership with your wife, did you discuss anything about the terms of the partnership, how it would operate, etc.?

A. Mr. Ray and I talked it over several times and we come to the conclusion that we would give my wife $50,000 and the balance in notes.

Q. You say you were to give your wife the balance in notes?

A. My wife would give me the difference in the price of the store, the difference in notes, payable yearly.

Q. Now, generally, what were the terms of that agreement that you spoke to Mr. Ray about; how was it to function?

A. The agreement was to pay the $50,000 and the balance of $55,000 in $5,000 notes each.

The Court: Do I understand your testimony to be, Mr. Lusthaus, that your wife actually paid over to you $50,000?

The Witness: Yes, sir; she did. $50,000 and three hundred something to make it an equal amount.

By Mr. Wallerstedt:

Q. I show you a paper entitled Articles of Agreement, Mr. A. L. Lusthaus—Abraham Lusthaus and Lillian Lusthaus—and ask you what that is?

A. This is the agreement that was drawn between Mrs. Lusthaus and myself.

Q. And is that your signature appearing on page 7?

[fol. 8] A. Yes, sir; it is.

Q. And is that the signature of your wife?

A. Yes, sir.

Mr. Wallerstedt: I offer in evidence paper shown marked Articles of Agreement, a photostat copy, the attorney for the other side having agreed to submit a photostatic copy instead of original.

Mr. McFarland: No objection.

The Court: That will be received in evidence and marked Petitioner's Exhibit 1.

(Copy of Articles of Agreement received in evidence and marked Petitioner's Exhibit 1, of this date.)

* * * Omission from Transcript pages 11 and 12.

By Mr. Wallerstedt:

Q. I show you a paper and ask you what that is?

A. This is a partnership return of the Household Furniture Company for 1940.

Q. By the way, Mr. Lusthaus, this partnership, under what name does it operate?

A. Household Furniture Company.

Q. How many stores do you operate?

A. Two stores.

Q. And what are the names of those?

A. One store is in the Household Furniture Company and the other store goes under the name of the Furniture Outlet.

Q. Both stores are operated under the partnership?

A. Both stores operate in one partnership.

Mr. Wallerstedt: I offer in evidence the partnership return for 1940.

Mr. McFarland: No objection.

[fol. 9] The Court: That will be marked Petitioner's Exhibit 3 and received.

(The partnership return for 1940 was received in evidence and marked Petitioner's Exhibit 3, of this date.)

By Mr. Wallerstedt:

Q. Mr. Lusthaus, since January 1, 1940, with the exception of this $20,000 that you drew out of the business, have you drawn out any cash or other property from the partnership?

A. Yes, sir.

Q. Has your wife drawn out any money?

A. Yes.

Q. Can you tell us just how you withdrew moneys, you and your wife?

A. My wife and I drawing a salary of $100 a week. I draw fifty and my wife draws fifty every week and from year to year at the end of the year, we have drawn out money whenever we need it from time to time.

Q. And in what proportions do you draw the money out?

A. It all depends. We draw sometimes large amounts or small amounts.

Q. Supposing that you draw out—if you draw out $10,000, how much would your wife draw out?

A. We divide equally, half. I take half and half goes to my wife.

Q. You get half and your wife gets half?

A. Half goes to me and half to my wife's account.

Q. Who kept the books of this partnership?

A. We have bookkeepers in the store keep the books.

Q. Do you have any public accountants?

A. Mr. Ross C. Tenney, public accountants.

[fol. 10] Q. Who are Tenney and Company?

A. They are public accountants in Uniontown. They have their offices there.

Q. Now, at the time you instructed your attorney to draw up these legal papers in the fall of 1939, what, if any, instructions did you give to Mr. Tenney?

A. I gave instructions to Mr. Tenney to close up the partnership—to close up my own as an individual and open up the partnership books.

Q. As of what date?

A. As of January 1, 1940.

Q. And did Mr. Tenney do that?

A. Mr. Tenney used the same books but he set up a partnership in the same books.

Q. He used the same books?

A. The same books, but he started as a partnership as of January 1, 1940.

Q. In other words, you made some adjustments to convert the books into a partnership?

A. Yes, sir.

Q. Can you tell me when Mr. Tenney was in your office working on these books making the necessary entries to convert the individual books into a partnership set of books?

A. I don't know exactly. I believe it was in January, 1940.

Q. Mr. Tenney was in the courtroom, was he not?

A. Yes, sir; he was.

Q. He was excluded?

A. Yes, sir.

Q. I show you a paper and ask you what that is, Mr. Lusthaus?

A. This is the bill of sale that I have taken and sold a half interest to Mrs. Lusthaus.

[fol. 11] Q. And whose signatures appear on that paper?

A. My signature first and Mrs. Lusthaus's underneath.

Q. And they are properly witnessed?

A. Yes.

Q. There is an Exhibit A attached to said paper, marked Balance Sheet, December 31, 1939?

A. Yes.

Q. Can you tell me who prepared that statement?

A. Tenney and Company, auditors.

Mr. Wallerstedt: I offer in evidence a photostat copy of the bill of sale.

Mr. McFarland: No objection.

The Court: It will be received and marked Petitioner's Exhibit 4.

(Photostat copy of the bill of sale was received in evidence and marked Petitioner's Exhibit 4, of this date.)

By Mr. Wallerstedt:

Q. I show you a check on the Second National Bank of Uniontown, drawn to your order in the amount of $50,253.81, signed by Lillian Lusthaus; is that her signature?

A. Yes, sir; this is Mrs. Lusthaus's signature.

Q. Did you receive that check?

A. I did.

Q. And what was it given to you for?

A. That was given in part payment of the interest that I sold to Mrs. Lusthaus.

* * * Omission from Transcript pages 16 and 17.

By Mr. Wallerstedt:

Q. I show you a set of papers clipped together consisting of 11 sheets and ask you what they are?

A. These are 11 notes at $5,000 apiece to be paid on the [fol. 12] first of each year until they are paid, given to me by Mrs. Lusthaus.

Q. For what purpose?

A. To pay for part of the rest of her interest in—that she bought in the Household Furniture Company.

Mr. Wallerstedt: I offer in evidence a photostatic copy of this group of notes.

Mr. McFarland: No objection.

The Court: That will be marked Petitioner's Exhibit 6 and received in evidence.

(Photostatic copy of 11 sheets of paper (notes) were received in evidence and marked Petitioner's Exhibit 6, of this date.)

By Mr. Wallerstedt:

Q. Have any of these notes been paid?

A. Three notes have been paid, one in January 1, 1941, and '42 and '43.

Q. And those notes are marked paid on this——

A. Yes.

Q. Has the interest on these notes been paid?

A. Yes, sir.

Q. Do you recall whether you included the interest that you received from these notes in your tax returns?

A. I did.

Q. Does the partnership have a bank account?

A. It has.

Q. In what name is that partnership?

A. Household Furniture Company.

Q. Did you have a personal bank account?

A. I have.

Q. Does your wife have a personal bank account?

A. Yes, sir.

[fol. 13] Q. Mr. Lusthaus, have you at all times since January 1, 1940 held yourself out to the public as a partnership?

A. I did.

Mr. Wallerstedt: You may cross-examine.

Cross-examination.

By Mr. McFarland:

Q. Mr. Lusthaus, when is the first time you met with F. W. Ries, Jr., of this city?

A. Off and on for several times. I don't remember exactly what would be the first time.

Q. When would you say, within what year or what part of the year?

A. Well, you could date it as far back as the late 1920's because Mr. Ries called on us at various times at the Cohen Furniture Company—I can't recollect how far back.

Mr. Wallerstedt: I don't believe this is proper cross-examination because it's not material and is therefore not proper cross-examination.

The Court: Let me rule on that.

Mr. McFarland, was there anything in direct examination that warranted those questions?

Mr. McFarland: The only thing I am trying to ascertain, if the Court please, I understand that Mr. Ries and Mr. Tenney—in addition, I am not certain—Mr. Lusthaus—I don't know who else—met in Uniontown around in September of 1939. That there were certain conclusions reached about the formation of a partnership involving Mrs. Lusthaus at that meeting and I'm just seeking to ascertain just what occurred in as much as the question of whether or not a partnership existed in the case is an [fol. 14] issue. I think that all these facts and circumstances surrounding the whole series of transactions should be probed, and I think that I have a right to examine them along these lines.

The Court: You may continue. I'm not sure whether it is correct cross-examination, but it's not very material whether it's brought out in cross-examination or whether the witness is called by the Government's own counsel in

as much as the Government counsel has now explained what he is driving at. I think it's probably all right.

Mr. McFarland: I may say at this time that I have subpoenaed Mr. Ries.

The Court: You have a right to call him on direct examination to bring out these questions. It's just a question of whether it is correct cross-examination. It's highly technical.

By Mr. McFarland:

Q. Directing your attention, Mr. Lusthaus, to September 1, 1939, I believe you had a conference with Mr. Ries and Mr. Tenney, did you not, at Uniontown?

A. Yes, I believe I did.

Q. What was discussed at that conference?

A. I believe it was discussed the partnership, to sell a half interest to Mrs. Lusthaus.

Q. Mrs. Lusthaus wasn't present at the time, was she?

A. I really don't remember; I don't know; possibly she was.

Q. Would you say she was or wasn't?

A. I'd say she wasn't.

Q. What was the reason for the discussion of whether or not you would form a partnership with Mrs. Lusthaus at this time?

[fol. 15] Mr. Wallerstedt: I object to that, your Honor.

The Court: Objection is overruled.

Mr. Hutchinson: If the Court please, this should be brought out by the Government's own witness and is not proper cross-examination. The reason for this agreement is not material to this issue.

The Court: Read back the last question.

(The last question was read back by the stenographer.)

The Witness: I didn't quite get it. What did you try what?

By Mr. McFarland:

Q. I just wanted to know the reason why you determined at this time, you and Mrs. Lusthaus, to form a partnership?

A. We were together most of the time and I decided to sell half an interest to Mrs. Lusthaus since Mrs. Lusthaus

has been with me in the store all the time working together, I decided to sell her a half interest and to make her half a partner in the store.

Q. Does Mrs. Lusthaus work with you in the store?

A. Very often.

Q. What does she do in the store?

A. Selling on the floor.

Q. She sells on the floor, does she?

A. At times she sells in the store whenever we are busy and need her she is in the store.

Q. You maintain a home in Uniontown?

A. I do.

Q. You have children?

A. I have.

Q. Does Mrs. Lusthaus take care of your home, too?

[fol. 16] A. I have a maid taking care of the home.

Q. Did you pay Mrs. Lusthaus a salary prior to the formation of this partnership when she worked for you?

A. Not before; we didn't.

Q. Her services were merely gratuitous; is that right?

A. Yes, sir.

Q. And in September 21, 1939 you decided to form a partnership?

A. I don't remember the exact date, but it was some time during 1939.

Q. At that conference that you held with Mr. Tenney and Mr. Ries, wasn't it determined that you should make a gift of $50,000 to Mrs. Lusthaus, and with that she should pay her part of her purchase price of the partnership?

Mr. Wallerstedt: I object to that. Where she got the money with which to pay for this partnership is immaterial.

The Court: Objections overruled.

The Witness: What was the question?

By Mr. McFarland:

Q. Were you not, as a result of the conclusions reached in that conference in Uniontown on September 21, 1939—did you not determine that you were to make a gift to Mrs. Lusthaus of $50,000 and with that and part of her own money to be added, she was to buy a half interest in the partnership? I should add, that in addition, issue certain

notes that were to be given to you to make up the full purchase price?

A. I don't remember how exactly we took that up at that time, but I had several discussions with Mr. Ray in [fol. 17] reference to the amount I should give Mrs. Lusthaus to buy a half interest in the store.

Q. You just gave it to her to buy the half interest? She was going to turn around and give you the money back?

A. Exactly.

Q. Did you file a gift tax return in 1940?

A. I did.

Q. And on that gift return, when did you state that you made the gift of $50,000 to Mrs. Lusthaus?

A. When?

Q. The date of the gift?

A. I don't remember.

Mr. Wallerstedt: I suggest you show him the return.

Mr. McFarland: I'll be very glad to.

By Mr. McFarland:

Q. (Showing paper to the witness) Is that your signature?

A. Yes, sir.

Q. And this is the gift tax filed by you for 1940?

A. Yes, sir.

* * * Omission from Transcript page 24.

By Mr. McFarland:

Q. When did you actually turn the money over to Mrs. Lusthaus pursuant to that agreement?

A. In June, 1940.

Q. By check?

A. By check.

Q. Would it be June 7, 1940?

A. The early part of June. I don't remember the date but it would be the early part of June.

Q. And on the same day when you paid Mrs. Lusthaus $50,000 in pursuance of your stated declaration to make a [fol. 18] gift to her in that amount, which, you said, gift was to be made on January 1, 1940, did you borrow any money from the Second National Bank of Uniontown?

A. I did.

Q. How much did you borrow from them on that day?

A. $20,000.

Q. Did you take that money in addition to the money that you withdrew from the partnership, and does that make up the gift that you gave her on June 7?

A. Yes, sir.

Q. That is, you didn't add any other money that you had from any other sources at that time, did you?

A. No, whatever money I had in my bank.

Q. I believe you testified that on June 18 you received by check from Mrs. Lusthaus the sum of $50,000—rather, $50,253.81?

A. Correct.

Q. And part of the purchase price under the terms of the bill of sale of the partnership?

A. Yes, sir.

Q. And did you pay off to the bank on the same date the amount of money that you borrowed on June 7?

A. I don't remember the exact date but I paid off the bank.

Q. You'd say it was paid off at about that time?

A. I presume it was about that time.

Q. When you borrowed the money from the Second National Bank, Mr. Lusthaus, on June 7, did you deposit it to your account?

A. I did.

Q. Did you discuss with Mrs. Lusthaus any of the conclusions reached at the meeting of September 21, 1939?

[fol. 19] A. I must have; I believe I did.

Q. Of course, in order to discuss the conclusions you'd have to first have had the meeting?

A. I have talked with Mrs. Lusthaus on several occasions during 1939 to make her a partner in the business.

Q. Did you ever arrive at any definite terms under which she would become a partner prior to that meeting?

A. I don't know. Mr. Ray and I have discussed it several times.

Q. What did you discuss with Mrs. Lusthaus?

A. That I would give her an outright gift of $50,000.

Q. You'd just make a gift to her of $50,000 and she would use that as the purchase price?

A. Yes, sir.

Q. How did you determine the purchase price of the partnership?

A. Through the books.

Q. Did you include the element of goodwill in that purchase price?

A. The what?

Q. What did you include in the purchase price?

A. The value of the business—of both stores.

Q. And how did you determine the value of the business?

A. Through the book value.

Q. And what did the book value take into consideration?

A. Merchandise, book accounts and other assets that we have in the store.

Q. By other assets you mean physical assets?

A. Physical assets.

[fol. 20] Q. When did your wife agree to buy in this partnership?

A. During the fall of 1939.

Q. What date?

A. I really don't know the date. It would be very hard for me to remember the date. We discussed it several times.

Q. As I understand it, you discussed it with your wife several times, but you never arrived at any definite conclusions or any conditions upon which the sale would be consummated; is that correct?

A. Well, we decided as of January 1, 1940.

Q. When did you decide as of January 1, 1940?

A. Some time in the later part of 1939.

Q. Did you have a written agreement at that time?

A. No, sir.

Q. Purely oral arrangement?

A. What?

Q. Purely oral arrangement?

A. Oral arrangement in Mr. Ray's office.

Q. And what were the terms of that oral agreement?

A. Just as I stated, that she would pay me $50,000 in cash and the balance to be paid in notes.

Q. Payable yearly?

A. Payable yearly in notes.

Q. In the amount of $5,000 each for 11 years?

A. Yes.

Q. Where was she to get the amount to be paid off yearly?

A. From the profits of the business.

Q. Did your wife, if you know, did your wife have any other available assets with which to purchase the business [fol. 21] other than what you were going—the amount you were going to give her?

A. No, she didn't have enough; she had some.

Q. How much did she have that actually went into the purchase price of the business?

A. That I can't tell you. I don't remember.

Q. Would it be $253.81?

A. I believe so.

Q. In other words, she added that to the $50,000 that you gave her to make up part of the purchase price?

A. To make up part of the purchase price.

Q. I believe you stated on direct examination that you and your wife were to draw equal portions from the business each year; is that correct.

A. After we became partners.

Q. And you state that you became partners on January 1, 1940?

A. As of January 1, 1940.

Q. If you know, how much did your wife withdraw from the partnership in 1940?

A. I really don't know.

Q. Would it be $59.61?

Mr. Wallerstedt: We expect to produce the books and the records showing all that.

Mr. McFarland: If he knows I think he is entitled to answer.

The Court: Yes, that's right.

Mr. Wallerstedt: If you remember.

The Witness: I don't remember how much she draws. We draw $100 weekly between the two of us.

By Mr. McFarland:

Q. And the records would show how much she withdrew?

[fol. 22] A. Yes, the records would show that.

Q. And the records of her withdrawals would be—where would I find them?

A. In the books of the Household Furniture Company.

Q. Under what category would they be kept?

A. I really don't know. My auditors would be very glad to show it to you?

Q. It probably would be under withdrawals of your wife?

A. There is a regular setup of our drawings. The bookkeeper takes care of that. I don't know.

Q. When did you notify your—Do you have a line of credit with any nationally known institutions?

A. I have.

Q. What are some of them?

A. Dun and Bradstreet——

Q. When did you notify—Will you finish your answer. I interrupted you.

A. Dun and Bradstreet.

Q. When did you notify Dun and Bradstreet that the partnership was in existence?

A. I really don't remember. I believe either during the year after June or the following January.

Q. Of 19——

A. 1941.

Q. Either June of 1940 or January?

A. Either during 1940 or 1941.

Q. Mr. Lusthaus, I will ask you if you will examine each of these four papers that are clamped together and ask if your signature appears on those papers?

A. Yes, sir, my signature appears right here (indicating). [fol. 23] Q. Does it appear on each of the four clamped documents?

A. It does.

Q. What are those documents?

A. These are employment tax returns.

Q. Filed by you?

A. Filed by me.

Q. For the year 1939?

A. Year 1939; yes, sir.

Q. I will ask you to examine the returns for the year 1940 and ask if your signature appears thereon?

—. Yes, sir.

Q. I likewise ask you to examine the returns filed for the year 1941 and as- the same question of you: Does your name appear thereon?

A. Yes, sir.

Q. In all of these it has been notarized, haven't they, in accordance with the provisions of the act?

A. Yes, sir.

Mr. McFarland: I'd like to introduce into evidence as Respondent's Exhibit B, C, and D, the social security or the employment tax returns filed by the Household Furniture Company for the years 1939, 1940 and 1941.

I may state that the amounts or figures thereon are in no way material to this case.

Mr. Wallerstedt: May I ask a few question on these?

Mr. McFarland: Surely.

By Mr. Wallerstedt:

Q. Mr. Lusthaus, who makes out these returns for you?

A. My bookkeeper, Miss Rose Christy.

[fol. 24] Q. And you know that they cover the employer's tax return?

A. They do.

Q. And that you sign them as she makes them out?

A. As she makes them out, I sign them.

* * * Omission from Transcript page 33.

The Court: Mr. Lusthaus, you had a bank account, I assume, prior to 1940?

The Witness: What's that?

The Court: You had a bank account prior to 1940?

The Witness: I have; yes, sir.

The Court: Did your wife have a bank account also?

The Witness: Before 1940 my wife and I had a joint account.

The Court: Joint Account?

The Witness: Joint Account.

The Court: Was there any change made in that joint account beginning with 1940 or in 1940?

The Witness: Yes, sir; Mrs. Lusthaus opened a separate account and so did I?

The Court: And in what account were the partnership funds deposited?

The Witness: Under the name of Household Furniture Company.

The Court: And who had a right to draw checks upon that partnership account?

The Witness: We both signed checks on the partnership account.

The Court: Was that by some agreement?

The Witness: Yes, sir.

[fol. 25] The Court: When was that arrangement with the bank made?

The Witness: That was made sometime this year. Mrs. Lusthaus could have signed checks any time.

The Court: How could she have signed them without authority of the bank?

The Witness: She had her signature here. It was there in the Household Furniture Company.

The Court: But you say that it wasn't until this present year that you gave the bank the right to accept her as a partner and the right to draw checks upon the partnership account.

The Witness: Yes, sir.

By Mr. McFarland:

Q. Mr. Lusthaus, Mrs. Lusthaus was not brought into your partnership until June 7, 1940; is that correct?

A. Correct.

Q. So she didn't have any authority to sign checks on behalf of the partnership of which she wasn't a member as of that date?

A. She didn't have at that time.

Q. The accounts were kept in one bank?

A. One bank.

Q. What bank was that?

A. Second National Bank, Uniontown.

Q. You signed these returns, did you not as owner through the years 1939 and 1940, Mr. Lusthaus?

A. Well, I signed my name. I believe the girl fills it out. I don't know exactly if it is "owner" or "partners." I usually sign my name.

Q. Well, if I showed you these you probably could determine——

[fol. 26] Mr. Wallerstedt: I think those documents speak for themselves.

Mr. McFarland: I notice that some of them are typewritten—some parts of them—and I'd like to examine him on that.

By Mr. McFarland:

Q. I direct your attention to the word "owner" appearing on the return for the quarter end of March 1, 1939 and ask you if that is your handwriting (indicating)?

A. (No response.)

Q. Does your handwriting appear under the same title for the return ending June 30, 1939?

A. This is not my writing.

Q. You examined it, of course, before you signed it?

A. I wouldn't say as a fact.

Q. And if it wasn't correct you'd correct it before you signed the return?

A. Not always. Miss Christy has full charge to do that work.

Q. You didn't look at that, you just signed it?

A. I usually signed it.

Q. And if she put your name down as partner or owner or president you wouldn't change or alter it one way or the other?

A. I don't think I would. I don't know. I probably would if I had seen it.

Q. Directing your attention to that part of the exhibit which is the return for the quarter ending June 30, 1941, how did you sign your name; in what capacity did you sign your name on that return (indicating)?

A. A. L. Lusthaus; I believe I signed "owner or owners." It's not a corporation.

[fol. 27] Q. How does it appear thereon?

A. "Partner" I believe (indicating).

Q. In what capacity did you sign the return for the quarter ending March 31, 1941?

A. Owner.

Q. Can you tell me from those returns, the latter two quarters of the year, in what capacity you signed?

A. Well, it would have to be signed, I believe, as owner.

Q. You examined the return, Mr. Lusthaus, you can determine from those?

A. You want to know what?

Q. I want to know in what capacity you signed the return for the quarter ended Sept.—what date does that bear—September 30, 1941 and for the quarter ended December 31, 1941?

A. September 30, 1941, "partner."

Q. December 31, 1941?

A. "Partner."

Q. The first time your name appears as a partner, Mr. Lusthaus, is in the return for the quarter end of June, the quarter end of June 30, 1941?

A. I believe so. The reason we don't use "partner" is because any time we place an order it's always placed under the name of Household Furniture Company. Our names very seldom appear, my name or Mrs. Lusthaus's name, unless it appears on checks, but we have no occasion of using our names.

Q. Except for the occasions that require you to sign in your official capacity as to these returns?

A. Yes, sir.

Mr. McFarland: I believe that's all.

[fol. 28] Redirect examination.

By Mr. Wallerstedt:

Q. I believe, you stated that your bookkeeper or your secretary, somebody in your office, makes these returns out. Is that a formality?

A. It's a formality.

Q. She just makes them out; the amounts involved are not large and you sign them?

A. I do.

Q. It's true that you operated as an individual up to 1940 and at that time you had to show under the name that is shown as "owner, president, partner, etc." and that prior to the partnership you marked them "owner?"

A. Yes.

Q. That is, it was generally typewritten on?

A. Yes, sir.

Q. And when it came to the succeeding years the girl just followed the old form, being a tax return, followed the old form and you signed them?

A. Yes, sir.

Mr. McFarland: The returns are present and it shows in what manner they were signed.

The Court: But I think that is proper redirect examination.

By Mr. Wallerstedt:

Q. Mr. Lusthaus, speaking of this checking account of the partnership, do you recall why it was, or was there any reason why you didn't open up a bank account as a partner with the authority of both of you to sign checks in the very beginning rather than this year?

A. There was no special——

[fol. 29] Mr. McFarland: May I object to that question, your Honor. I believe it's not a question of what he intended to do or why he didn't do something, but rather what he actually did do that is material to the case. I don't think that it is competent in that respect.

The Court: Objection overruled.

The stenographer will read back the last question to the witness.

(The last question was read back to the witness.)

The Witness: Your Honor, all bills that come in I check up. My contract with my wife is that I have full charge of the business, to run it, the business, as I did before, and therefore it wasn't really necessary for Mrs. Lusthaus to have any signature. It didn't matter if she did or did not because every bill paid I checked up—every bill with reference of a discount that we get, and therefore everything that is there I do.

By Mr. Wallerstedt:

Q. Would you say that was an oversight?

A. I would, yes, because I do just—I could just as well have her signature there because there was no reason why her signature should be there.

Q. What brought it you your attention this year, if you recall?

A. I have just thought of this year to open an account. I don't remember.

Q. Not to open the account?

A. To authorize her signature on that account.

Q. Is it your practice for you to sign checks in the office or does your wife sign checks for business affairs?

[fol. 30] A. I sign checks.

Q. So far as the bank account itself is concerned, it is part of the assets of the partnership, is it not?

A. Yes, sir; it is.

Q. And there Mrs. Lusthaus, from the start of the partnership, did own one-half of that cash account?

A. Oh, yes.

Mr. McFarland: I object, if the Court please. I believe Mr. Wallerstedt is testifying now rather than the witness.

The Court: That objection is sustained.
Mr. Wallerstedt: That's all from this witness.

Recross-examination.

By Mr. McFarland:

Q. You paid the bills and conducted all the commercial end of the business when you were the sole proprietor, didn't you?
A. I did.
Q. You do the same now, isn't that correct?
A. Well, checking the bills and everything.
Q. You hire and fire the employees, don't you?
A. We both do.
Q. You file the social security returns, don't you?
A. Yes, sir; the office does the filing.
Q. You pay by check the various bills that are rendered to you as the partnership; isn't that correct?
A. Yes, sir.

Mr. McFarland: That's all.
The Witness: The bookkeeper does the work.

By Mr. McFarland:

Q. You sign them?
A. Mrs. Lusthaus doesn't sign them.
Q. If she just happens to be there at that time?
[fol. 31] A. I am there every day.
Q. You conduct the business?
A. I do.
Q. I think, under the terms of the partnership, you do most of the business, don't you? You determine the policy of the business?
A. We discuss it with Mrs. Lusthaus when anything special comes up. We discuss it as we did before.
Q. You discussed it with her before, before the partnership came up, when you were going to buy a new building, or make a drastic change in your policy, you discussed that with her, didn't you?
A. We never had any occasion of buying a building.
Q. I'm just using that as an example. Maybe it didn't exist.
A. I believe we would.

Mr. McFarland: I believe that's all.

Mr. Wallerstedt: I'm not going into this very much because it's specifically set forth in the partnership agreement what his duties are as manager of the business.

That's all, Mr. Lusthaus.

(Witness excused.)

[fol. 32] Lillian Lusthaus, called as a witness in behalf of the Petitioner, being duly sworn, testified as follows:

The Court: Give your name and address to the stenographer.

The Witness: Lillian Lusthaus, 170 Stockton Avenue, Uniontown, Pennsylvania.

Direct examination.

By Mr. Wallerstedt:

Q. Are you the wife of Mr. A. L. Lusthaus, the taxpayer petitioner in this case?

A. Yes.

Q. And your name is Mrs. Lillian Lusthaus?

A. Yes.

Q. When were you married, Mrs. Lusthaus?

A. 1915.

Q. Your husband has testified here that he has been in the furniture business in Uniontown since 1918. Did you help him in this business to any extent, and if so, what did you do?

Mr. McFarland: I object to the form of the question, if the Court please. I believe that is leading the witness. I would just like to have Mr. Wallerstedt ask her what she did.

The Court: Will the stenographer read back the last question.

(The last question was read back by the stenographer.)

The Court: The objection is overruled. She may answer the question.

The Witness: I worked with him in the business. You mean, what did I do in the store?

[fol. 33] By Mr. Wallerstedt:

Q. Yes.

A. Waited on trade; made cash receipts; took cash, and helped in any way in any part of the store that I was needed in.

(Off-the-record discussion.)

By Mr. Wallerstedt:

Q. Will you explain what you did in your husband's store up to 1940, January 1, 1940?

A. I came to the store pretty regularly and sold to the trade, made cash, made receipts, and helped in any way that was necessary for me to do.

Q. Did you get any salary from your husband prior to January 1, 1940?

A. No.

Q. Why did you not get any compensation?

A. Well, I felt that anything that he had was mine and if I need money I always came to him for it and he gave it to me. He never refused me anything.

Q. Did you discuss anything with your husband in 1939 with your husband about his business affairs?

A. Yes.

Q. Can you tell me what your discussions were in general terms?

A. Well, he talked to me about my becoming a partner in the business and suggested that I buy a half interest in the business.

Q. And what was your thought on the subject?

A. I thought it was a very fine idea.

Q. And about what time was that; if you recall?

A. It was in the fall.

Q. In the Fall?

A. Of 1939.

[fol. 34] Q. Do you recall as to when the partnership was to go into effect; right away or when?

A. It was to become effective January 1, in 1940.

Q. That was entirely agreeable to you, was it?

A. Oh, yes.

Q. Do you recall the terms of this, how you were going to enter into this partnership agreement?

A. Well, he said that he had a plan where he could make me a gift, give me $50,000, and I would pay that as part of

the partnership, and the balance in notes, in equal notes, over a period of years.

Q. And what did you say to that?

A. I thought that was a very good idea.

Q. Did you have any property of your own on January 1, 1940?

A. Yes.

Q. Do you know what that consisted of, those properties; do you recall?

A. I had my home and I had some stocks.

Q. What type of home? What would be the approximate value of that home?

A. About 25 or $30,000.

Q. Do you recall the approximate value of any securities that you owned at that time?

A. I'd say 20,000, $25,000; something like that.

Q. I show you a paper that is marked petitioner's Exhibit 1, being the Articles of Agreement of partnership and ask you if that is your signature (indicating)?

A. It is.

Q. You have your own bank account?

A. I do.

Q. Do you recall when your own bank account was opened?

A. When it was opened?

[fol. 35] Q. When, approximately?

A. My personal bank account?

Q. Yes.

A. Oh, I don't recall; a good many years ago.

Q. This account is entirely separate, is it, from the partnership account?

A. Entirely separate.

Q. In what name does your individual account stand?

A. Lillian Lusthaus; my name.

Q. Does the partnership have a bank account?

A. Yes.

Q. Do you know what name it's under?

A. Household Furniture Company.

Q. Have you received any moneys from this partnership since January 1, 1940?

A. The partnership—yes.

Q. Under what circumstances do you get money from the partnership?

A. Well I draw $50 a week and then at intervals, when there are profits accrued, get divide those profits and I am credited with half and my partner is credited with half.

Q. And that is on the accounts of the partnership books?

A. On the partnership books.

Q. Do you actually get any cash out of the business?

A. Yes.

Q. What do you do with that cash?

A. Use it for whatever I need.

Q. Do you deposit it to your own personal account?

A. Always.

Q. Since January 1, 1940, have you reported your share [fol. 36] of this partnership income to the Federal Government?

A. Yes.

Q. Mrs. Lusthaus, I show you a paper and ask you if you will tell me what that is?

A. My tax return.

Q. For what year?

A. 1940.

Q. Is that your signature—I think the signature is on the other side (indicating)?

A. Yes, there it is (indicating).

* * * Omission from Transcript pages 48 and 49.

By Mr. Wallerstedt:

Q. I show you a paper marked Petitioner's Exhibit 5 and ask you if you know what that is?

A. That is the check I gave to Mr. Lusthaus in part payment of the partnership arrangement.

Q. I show you a pack of papers and ask you if you recognize those papers. These papers are marked Petitioner's Exhibit No. 6.

A. Yes.

Q. These are the notes?

A. My notes for a period of years; 11 notes.

Q. Is that your signature on all those papers?

A. Yes.

Q. Have any of these notes been paid?

A. Yes.

Q. Do you recall which ones?

A. Yes; 1940, '41—'41, '42, '43; three notes.

Q. I show you a paper marked Petitioner's Exhibit No. 4 and ask you if that is your signature appearing on page 3 (indicating)?

A. Yes.

Q. These papers which I have just shown you being the [fol. 37] bill of sale and the notes and the partnership agreement, who prepared those papers?

A. My attorney.

Q. And who is your attorney?

A. Joseph Ray.

Q. Who prepared your tax return for you?

A. Mr. Tenney; Tenney and Company.

Q. He is a public accountant?

A. Public accountant; Uniontown.

Mr. Wallerstedt: Cross-examination.

Cross-examination.

By Mr. McFarland:

Q. Mr. Ray is also your husband's attorney, Mrs. Lusthaus?

A. He is.

Q. Referring to the terms of the sale of the partnership interest by your husband to you, you didn't have any money to buy into the partnership in July 7, 1940?

A. I didn't have enough money for it at all. I had enough money for a part interest after I got the gift from him.

Q. You just took the gift and gave it right back to him?

A. On the advice of counsel I did what he told me to do.

Q. Did you or didn't you do that?

A. Yes.

Q. And the agreement that you had with your husband was that he would give you the $50,000 which you would use to buy into the partnership; isn't that right?

A. Yes.

[fol. 38] Q. And you also executed these 11 notes?

A. Yes.

Q. They are payable in what fashion?

A. $5,000 a year for 11 years.

Q. How much do you withdraw from the partnership weekly?

A. $50.

Q. And how much do you believe you withdraw from the partnership in the year 1940?

A. The year when?

Mr. Wallerstedt: Your Honor, the records will show——

By Mr. McFarland:

Q. The year 1904?

A. How much? I wouldn't remember exactly how much I withdrew.

Q. Would you approximate that for us?

A. 1940?

Q. Would it be $1,000 or $50,000?

Mr. Wallerstedt: I don't see the use in guessing. We'll have the actual papers here.

The Witness: I don't know. I couldn't tell you exactly.

By Mr. McFarland:

Q. Have you ever met Mr. Ries?

A. I have seen him.

Q. You never met him, have you?

A. I think I was introduced to him once.

Q. Did you attend a conference in Uniontown on September 21, 1939 in which Mr. Ries was present?

A. No; no.

Q. Did you discuss the conclusions reached between your husband and Mr. Ries and Mr. Tenney at that conference?

[fol. 39] A. No, I don't remember any conference with Mr. Ries.

Q. When is the first time that you knew of the terms of this partnership agreement that you subsequently signed?

A. When Mr. Lusthaus broached the subject to me.

Q. When was that?

A. In 1939; in the fall.

Q. In the fall of '39?

A. Yes.

Q. And this is the partnership agreement that you actually reduced to writing in June 7, 1940; is that correct?

A. Yes.

Q. You hadn't bought into the partnership on January 1, 1940?

A. We had discussed it up to then; discussed it.

Q. Did you discuss how you were to buy in your interest?

A. Yes.

Q. And how were you to do that?

A. Mr. Lusthaus was to give me a gift of $50,000 and I was to give that as part payment of the business of the partnership and the balance in notes.

Q. I think you added a small part in cash of your own.

A. Yes, I added cash.

Q. About two hundred and some odd dollars?

A. (No response.)

Q. It was a small amount?

A. Yes.

Q. You didn't sell any of your securities or did you sell the house?

[fol. 40] A. No.

Q. You didn't sell any of your securities or the house to raise money to buy the business?

A. No.

Q. Do you recollect how much money, how much cash you had in your bank account on December '39 or January of 1940?

A. In December; how much cash?

Q. If you know?

A. No, I don't recollect.

Q. Was it a substantial amount?

A. I couldn't say; I don't know.

Q. Under the terms of the partnership, how were you to share profits and losses with your husband, in what proportion?

A. Fifty per cent; half.

Q. Half each?

A. Yes.

Q. I hand you a document and ask you what that is?

A. That is a tax return for 1938.

Q. Does your signature appear there?

A. No. Yes, there it is, right up there, for 1938 (indicating).

Q. That was filed with the Commissioner by you?

A. Why, yes.

Q. I hand you another document and ask you what that document is?

A. 1939 tax return.

Q. Does your signature appear thereon?

A. Yes.

Mr. McFarland: Respondent seeks to introduce in evidence as Exhibits E and F the individual tax returns filed [fol. 41] by Lillian Lusthaus for the year 1938 and 1939.

Mr. Wallerstedt: I would like to ask for the reason why these should go in. They seem to be immaterial to me.

Mr. McFarland: I think they are material in this respect. I seek to show that Mrs. Lusthaus's financial condition as evidenced by the income tax returns prior to the date of the so-called articles of partnership and prior to the agreement that she has testified was entered into between herself and her husband. I think it all goes into the whole picture to give your Honor the full picture of the status and the relationship between the two individuals.

* * * Omission from Transcript Page 55.

By Mr. McFarland:

Q. Mrs. Lusthaus, have you had any dealings with any credit agencies?

A. No.

Q. Your husband handles all that?

A. My husband takes care of that.

Q. What do you do now with relation to the company, if anything?

A. Just go into the store, into one of the stores, particularly, and just do what is necessary; wait on trade, as I said; do what I have to do there; anything that needs to be done; wait on trade and cashier.

Q. The same you have always done?

A. Same as I have always done; yes.

Mr. McFarland: I believe that is all.

Mr. Wallerstedt: That is all, Mrs. Lusthaus.

(Witness excused.)

[fol. 42] Ross C. Tenney, called as a witness in behalf of the Petitioner, being duly sworn, testified as follows:

The Court: Please give your name and address to the stenographer.

The Witness: Ross C. Tenney, Uniontown, Pennsylvania.

Direct examination.

By Mr. Wallerstedt:

Q. Your name is Ross C. Tenney?
A. That's right.
Q. What is your business?
A. Public accountant.
Q. Where do you practice?
A. In Uniontown and vicinity.
Q. How long have you been in the public accounting business?
A. Since 1927.
Q. You operate your own business?
A. Yes, sir.
Q. Do you know Mr. Lusthaus, the taxpayer petitioner in this case?
A. I do.
Q. Has he ever retained your services as an accountant?
A. Yes, sir.
Q. For how many years; if you remember?
A. Seven or eight years.
Q. Do you audit his books, the partnership books, and his books prior to——
A. Yes.
Q. Are the partnership books in this room?
[fol. 43] A. Yes.
Q. Do you know who keeps these books and records?
A. Yes, sir.
Q. Will you please state?
A. His bookkeeper keeps the detailed records and our office keeps the general ledger.
Q. You mean your office makes all the entries in this general ledger?
A. In this general ledger.
Q. Back in 1939, did you do some work for Mr. Lusthaus?
A. I did.
Q. Can you explain what that work was?

A. Mr. Lusthaus contemplated entering into a partnership and he asked me to prepare his statement showing the value of the property—the proprietorship—as it stood at that time.

Q. And did you make such a statement?

A. I did.

Q. I show you Petitioner's Exhibit No. 4, which has attached thereto an exhibit. Will you please tell me what that exhibit is?

A. That is a balance sheet of the business of the Household Furniture Company then owned entirely by Mr. Lusthaus as of December 31, 1939.

Q. Is that the statement that you prepared?

A. It is.

Q. Do you recall when you prepared that statement?

A. Sometime in January of 1940.

Q. Besides making up this statement of the individual business, did he instruct you in any other way?

[fol. 44] A. Yes, he also instructed me to prepare a statement reflecting the condition of the business after it would be divided into two equal parts.

Q. Did he ask you to open up any books or new books?

A. He asked me to prepare the books on a partnership basis beginning as of January 1.

Q. And did you do that?

A. I did.

Q. And when were you there making these entries?

A. The entries were made in our own office sometime in January.

Q. Of what year?

A. Of 1940.

Q. Can you tell me why you didn't open up a new set of books rather than use the old books?

A. Well, it was simple—it was a simple matter to simply close out on the proprietorship account of A. L. Lusthaus and close out the individual investment account and make up accounts for two partners in the same set of books.

Q. That saved the cost of——

A. Opening a new set of books.

Q. What type of entries did you make? I am not asking about the actual entries but what type of entries did you make in these books to reflect the partnership?

A. Journal entries.

Q. Journal entries. And what were those journal entries?

A. I made a journal entry closing out the "investment" accounts of A. L. Lusthaus and opening an "investment" account for A. L. Lusthaus and L. C. Lusthaus. I believe [fol. 45] that is the way they are reflected on the books.

Q. Did you close up the books of Mr. Lusthaus for the year 1939?

A. I did.

Q. Did you prepare the partnership returns, tax returns for 1940 and the return of the partners?

A. I did.

Q. Did you prepare a gift tax return for Mr. Lusthaus?

A. I did.

Q. I show you a paper marked Respondent's Exhibit A and ask you what that is?

A. That is a gift tax return for the calendar year 1940 for A. L. Lusthaus.

Q. Did you prepare this return?

A. I did.

Q. I direct your attention to the second page showing a gift of cash of $50,000 listed here as January 1, 1940. Do you have anything to say about that?

A. We simply—I made the return as of the date that the partnership was effective although the money was not actually transferred until a later time.

Q. You didn't have any purpose at all of putting that on——

A. None whatever.

Q. At my request, have you recently prepared certain statements from the books and records of the partnership and of the individual?

A. Yes, sir.

Q. I show you a paper and ask you what that is?

A. That is a balance sheet of the Household Furniture Company as of December 31, 1939.

[fol. 46] * * * Omission from Transcript p. 61.

By Mr. Wallerstedt:

Q. I show you another paper and ask you what that is?

A. That is a balance sheet of the Household Furniture Company as of January 1, 1940.

Mr. Wallerstedt: I offer in evidence the balance sheet of January 1, 1940, of the Household Furniture Company.

Mr. McFarland: No objection.

The Court: That will be marked Petitioner's Exhibit 9 and received.

(Balance sheet of the partnership as of 1/1/40 was received in evidence and marked Petitioner's Exhibit 9 of this date.

By Mr. Wallerstedt:

Q. I show you another paper and ask you what that is?

A. That is the balance sheet of the Household Furniture Company as of May 31, 1940.

Q. All these papers I am referring to have been prepared by you?

A. Yes, sir.

Q. From the books and records of the Household Furniture Company?

A. Yes, sir.

* * * Omission from Transcript pages 62 and 63.

By Mr. Wallerstedt:

Q. I show you a paper and ask you what that is?

A. That is a balance sheet of the Household Furniture Company as of December 31, 1940.

Mr. Wallerstedt: I offer in evidence the balance sheet of the Household Furniture Company as of December 31, 1940.

[fol. 47] Mr. McFarland: No objection.

The Court: It will be received as Petitioner's Exhibit 11.

(Balance sheet of the Household Furniture Co. as of 12/31/40 was received in evidence and Marked Petitioner's Exhibit 11, of this date.)

* * * Omission from Transcript pages — and —.

By Mr. Wallerstedt:

Q. I show you another paper and ask what that is?

A. That is a statement of income, profit and loss for the period June 1 to June 30, 1940 of the Household Furniture Company.

* * * Omission from Transcript Page 65.

By Mr. Wallerstedt:

Q. I show you another paper and ask you what that is?

A. That is an analysis of the investment accounts from January 1, 1940 to December 31, 1940, showing the details of the various entries to those accounts for that period.

Mr. Wallerstedt: I offer in evidence analysis of investment accounts for the period from January 1, 1940 to December 31, 1941, of the Household Furniture Company.

Mr. McFarland: No objection.

The Court: Received as Petitioner's Exhibit 15.

(Analysis of investment accounts for 1/1/40 to 12/31/41 of the Household Furniture Company was received in evidence and marked Petitioner's Exhibit 15, of this date.)

[fol. 48] By Mr. Wallerstedt:

Q. I show you another paper and ask you what that is?

A. That is an analysis of the withdrawals made by the partners from January 1, 1940 to December 31, 1940, showing what the withdrawals were made for.

Mr. Wallerstedt: I offer in evidence analysis of withdrawals of Mr. and Mrs. Lusthaus for the period from January 1, 1940 to December 31, 1941.

Mr. McFarland: No objection.

The Court: Received as Petitioner's Exhibit 16, and marked.

(Analysis of withdrawals of Mr. and Mrs. Lusthaus from 1/1/1940 to 12/31/1941 was received in evidence and marked Petitioner's Exhibit 16, of this date.)

By Mr. Wallerstedt:

Q. I show you Petitioner's Exhibit 15 and also Exhibit 16, and ask you if Exhibit 16 is a detail of entries shown in Exhibit 15?

A. No, sir. This is an analysis of the withdrawal accounts. That was the final total that was posted to the investment account itself, whereas the final result is posted to the investment account.

Q. In other words, they charge all withdrawals to the individual accounts and——

A. Then any debits or credits for withdrawals or loans to the business of money or anything of that kind is run through a personal account or so-called withdrawal account.

Q. That is Exhibit 16?

A. That's right. Then at the end of the year that account is either debited or credited to the investment account.

[fol. 49] Q. So that the amount here on Exhibit 16 shows, less cash advances by partner, or being a net figure of $4,604.76 as the amount that appears on this?

A. That is correct.

Mr. Wallerstedt: You may cross-examine.

Cross-examination.

By Mr. McFarland:

Q. Mr. Tenney, regarding the gift tax return that you have prepared for Mr. Lusthaus, that you stated you entered thereon, the gift was made January 1, 1940?

A. That's right.

Q. Why did you handle it in that fashion when the actual transfer of the money didn't occur until some six months later?

A. As I explained in my answer, I said that that was done as of the date of the beginning of the partnership and didn't think it made any difference. I didn't have any particular reason behind doing that except that was the date it should have been done and wasn't done.

Q. Are you familiar with the terms of the agreement of the bill of sale and the agreement of the articles of partnership?

A. I read it. I wouldn't say I am familiar with it; no.

Mr. McFarland: I believe that is all.

Mr. Wallerstedt: That's all.

(Witness excused.)

[fol. 50] Joseph W. Ray, Jr., called as a witness in behalf of the Petitioner, first being duly sworn, testified as follows:

The Court: Please give your name and address to the stenographer.

The Witness: Joseph W. Ray, Jr., Fayette Title and Trust Building, Uniontown, Pennsylvania.

Direct examination.

By Mr. Wallerstedt:

Q. Mr. Ray, what is your business?

A. I am a lawyer.

Q. How long have you practiced law?

A. A little more than 30 years; since September 1913.

Q. Can you tell us when you were admitted?

A. I have been admitted to the Appellate Courts of Pennsylvania and the Supreme and Superior Courts; the Court of the Common Pleas of Fayette County, Pennsylvania; the United States District Court for the western district of Pennsylvania; the Circuit Court of Appeals for the Third Circuit, and to this Tax Court—Federal Tax Courts.

Q. Do you know Mr. Lusthaus, the petitioner in this case?

A. I do.

Q. Is he your client?

A. He is.

Q. How long has he been your client?

A. I think since about January 1, 1938. Judge W. Russell Carr was Mr. Lusthaus's attorney until Judge Carr went on the bench. I think he was elected in '37 and since that time I have represented Mr. Lusthaus.

[fol. 51] Q. I show you Petitioner's Exhibit 4 and Exhibit 1 and ask you if you prepared those documents?

A. I did. They were executed in my office in my presence.

Q. Will you please state how you came to prepare these documents?

A. The negotiations leading up to the preparation of those documents began, so far as I am concerned, in either June or July 1939. At that time Mr. Lusthaus came and consulted me in regard to making his wife a partner in his business. I had a number of talks with him and it was determined that he would sell one-half interest in the business to his wife, that a partnership agreement would be entered into effective as of July 1, 1939. Such an agreement was prepared some time in the fall of 1939, which was in substance practically the same as the agreement that was subsequently signed in June 1940, effective as of January 1, 1940. The agreement prepared in 1939, however, was not executed because after consultation with Mr. Lusthaus and after consultation with Mr. Tenney, he rather

advised that it would be much better to make the change as of the first of January, 1940. It was then decided not to do that and the agreement that I first prepared some time in the fall of 1939 was not executed and the change was made later as of January 1, 1940.

Q. Do you remember what reason Mr. Tenney gave?

A. Well, it was decided, I think, largely on my advice, that the consideration for the agreement should be the book value of the business. There would be an inventory made as of the close of business of the 31 of December. There wasn't any physical inventory made as of June 30, and therefore Mr. Tenney thought it would work out from [fol. 52] a bookkeeping standpoint much better to make the change at the beginning of the calendar year rather than in the middle of the calendar year. That is my recollection of what Mr. Tenney told me.

Q. Why were these partnership—What instructions did Mr. Lusthaus give to you with respect to these partnership agreements and any other legal papers?

A. Well, he instructed me to prepare them after many consultations in my office. Mr. Lusthaus's place of business is in the same building as is my office. I saw him very frequently during the summer and fall of 1939. I suppose this matter was discussed thirty times between Mr. Lusthaus and myself. It was—he first talked about making a gift to his wife of an entire half interest in the business but after consultation he decided that taking into consideration all of his financial affairs, that it wasn't advisable to do that and then this plan that was carried out was decided upon by which he was to make the gift of the $50,000 and she was to buy the half interest, paying for it with the $50,000, the subject of the gift, plus the 11 notes, totaling the balance of the consideration.

Q. Did he tell you when to make these papers, these partnership agreements, effective?

A. He first told me——

Mr. McFarland: If the Court please, I object to the question. The articles of partnership have been introduced and the dates speak for themselves. What Mr. Lusthaus intended, I don't think is an issue.

The Court: I don't think he asked for an intention. Objection overruled.

The Witness: He told me in the first instance that they [fol. 53] were to be prepared and made effective as of June 30, 1939, and they were so prepared.

By Mr. Wallerstedt:

Q. Subsequent to that?

A. After our numerous conferences with Mr. Tenney I was instructed to prepare the papers which were to become effective as of January 1, 1940.

Q. The papers show that they were executed, I believe, on June 4, of 1940.

A. That's correct.

Q. Why were they not prepared as of, say, in December, so that they would become effective right on the date they started the partnership?

A. Mr. Wallerstedt, all that I can say about that is that it is entirely my responsibility. I became ill in December 1939. In January—through December *in* January I was not feeling very well. I am subject to colds and I have had pneumonia a number of times, and I was laid up with the grippe and the papers were not prepared.

Early in January of 1940 I decided to go away. Mrs. Ray and I got ready to go to Mexico; largely because I had been ill. My recollection is we planned to leave Uniontown the 17th or 18th of January, but about the time I was to leave or possibly the day before I was to leave, L. J. Hughes, of Fayette County, who was a client of our office, became ill in New Mexico and a few days later died out there and I determined that I should stay in Uniontown until his body was brought back and the burial services were held, and I did that.

I left Uniontown, I think, on the 24 or 25 of January. Mrs. Ray and I drove to Mexico City. We got back to Uniontown about the first of March. Either about that time or within a day or two, or a few days after, we re- [fol. 54] turned to Uniontown and Mr. Lusthaus left for Florida.

Q. Alone?

A. I am not sure. I think his wife went with him. I think they both went. I am sure they did. He was gone four or five or six weeks. During that time, my recollection is that some work was done on these papers and they were finally prepared and when he came back he was called

to my office and he and his wife came in and they were checked up again and possibly some corrections made and they were finally, at long last, signed and executed on the 4th of June, also in my office.

Q. Did you, at the time that you became sick and found it necessary to postpone drawing up these papers, did you in any way advise Mr. Lusthaus as to the partnership?

A. I did. I told him, Mr. Lusthaus, and also told Mr. Tenney—had a full and complete understanding—that the change was to be made and that the papers were to be prepared subsequently, effective as of January 1, 1940. Mr. Tenney was to make the change in the books, and I never saw the books, but I understood that that had been done prior to the time I left home to go to Mexico.

Q. Mr. Ray, in your opinion as a lawyer, and under the laws of the State of Pennsylvania, was this partnership agreement that was signed on June 4, 1940 effective as of January 1, 1940?

Mr. McFarland: I object, if the Court please.

The Court: Objection sustained.

Mr. Wallerstedt: I will withdraw the question.

By Mr. Wallerstedt:

Q. Is the partnership your client at the present time?

[fol. 55] A. It is.

Q. Do you know whether or not the affairs of the partnership have been conducted as a partnership since January 1, 1940, publicly?

Mr. McFarland: I object.

Mr. Wallerstedt: I ask him if he knows.

Mr. McFarland: I object to the question, your Honor. That is one of the ultimate issues in the case: whether or not the partnership has been conducted publicly as a partnership or as a sole proprietorship or in what fashion.

The Court: Objection overruled.

The Witness: I do.

By Mr. Wallerstedt:

Q. Will you state some of the acts that were done by the partnership which would lead you to that answer?

A. Well, the two partners signed the partnership agreement. I have, on numerous occasions, talked to both Mr.

Lusthaus and Lillian C. Lusthaus. At their request I filed sometime in 1940 ficticious name certificates both with the Secretary of the Commonwealth and with the Prothonotary of the Court of Common Pleas of Fayette County, stating that they were engaged in business as partners. Those certificates being signed by both of them, and, I believe, and both acknowledged and sworn to.

I know from my connection with the business that when they institute proceedings for recovery of furniture that's been sold on bailment leases, that those proceedings are in the name of the partnership. I know that any other proceedings I have are instituted that way. I know that so far as all the legal aspects of the business are concerned, it is [fol. 56] conducted as a partnership.

Q. I show you a paper and ask you what that is?

A. That is a certificate doing business under fictitious name, filed, issued by the deputy secretary of the Commonwealth to A. L. Lusthaus and Lillian Lusthaus, authorizing them to engage in the business under the fictitious name, Household Furniture Company.

Mr. Wallerstedt: I offer in evidence the certificate of the Commonwealth of Pennsylvania, under the Fictitious Names Act authorizing Mr. and Mrs. Lusthaus to operate under the assumed or fictitious names of the Household Furniture Company.

The Court: What is the date of that certificate?

Mr. Wallerstedt: This certificate is dated July 31, 1940.

Mr. McFarland: No objection.

The Court: That will be received as Petitioner's Exhibit 17.

(Certificate of doing business under fictitious name of partnership dated 7/31/40 received in evidence and marked Petitioner's Exhibit 17, of this date.)

By Mr. Wallerstedt:

Q. I show you a similar paper and ask you what that is?

A. That is a certificate issued by the deputy secretary of the Commonwealth to A. L. Lusthaus and Lillian Lusthaus authorizing them to do business under the fictitious name of the Furniture Outlet Store, place of business, Uniontown.

Q. And that is dated July 31, 1940?
[fol. 57] A. That is correct.

* * * Omission from Transcript pages 77 and 78.

By Mr. Wallerstedt:

Q. I show you another paper and ask you what that is?
A. That is a certificate of John J. Brady, Prothonotary of Fayette County, stating that the fictitious name certificate has been filed by A. L. Lusthaus and Lillian Lusthaus doing business as the Furniture Outlet Store.
Q. And that is dated——
A. August 1, 1940.

* * * Omission from Transcript pages 78 and 79.

By Mr. Wallerstedt:

Q. I show you another paper and ask you what that is?
A. That is a certificate issued by John J. Brady, Prothonotary of Fayette County, to A. L. Lusthaus and Lillian Lusthaus, certifying that they have filed fictitious name certificate for the purpose of doing business as Household Furniture Company, 52 West Main Street, Uniontown, Pennsylvania.

* * * Omission from Transcript page 79.

By Mr. Wallerstedt:

Q. You state that you filed applications for these certificates, did you not?
A. That is right.
Q. Why did you not file those applications earlier?
A. Well, for the same reason that there was a delay in getting the matter closed, and I had quite a delay in filing these certificates. I can't answer that. I don't know.
Q. When you filed your application you attached to that [fol. 58] application a copy of the partnership agreement?
A. You do not. They are made out, Mr. Wallerstedt, on a form that is a different or separate form, furnished by the Prothonotary, and the other is a form furnished by the Secretary of the Commonwealth.

Mr. Wallerstedt: That's all. You may cross-examine.

Cross-examination.

By Mr. McFarland:

Q. Mr. Ray, the actual transaction whereby Mrs. Lusthaus purchased in the business was consummated some time in June of 1940; is that right?

A. Yes, that is what I learned about.

Q. I refer at the time Mr. Lusthaus actually made a transaction whereby he issued a check to her?

A. That is correct. That was in June of the same time the agreement was actually signed.

Q. That is right. And she issued her check to him for the part of the purchase price plus the execution of the 11 notes?

A. That's right.

Q. All that occurred in June of 1940?

A. That's correct.

Mr. McFarland: That is all.

Mr. Wallerstedt: Petitioner rests.

Mr. McFarland: I have just one witness, if the Court please.

(The witness was excused.)

[fol. 59] F. W. Ries, Jr., called as a witness in behalf of the Respondent, first being duly sworn, testified as follows:

Direct examination.

By Mr. McFarland:

Q. What is your name?

A. F. W. Ries, Jr.

Q. Where do you live?

A. 1150 Union Trust Building, Pittsburgh, Pennsylvania.

Q. What is your profession?

A. Well, I am the manager of the Canada Life Assurance Company and I am also a member of the Bar of Allegheny County.

Q. When did you first meet Mr. A. L. Lusthaus of Uniontown?

A. My first meeting was about 1932.

Q. In what capacity did you meet him?

A. Our Mr. Boggs, one of our representatives, was talking to Mr. Lusthaus about setting up his estate with a view

of selling him insurance if he hadn't enough to take care of his taxes.

Q. Directing your attention to September of 1939, did you have a meeting with him at Uniontown?

A. Yes, we did.

Q. What was the date of that meeting?

A. September 19 was one meeting. I think we had a meeting previous to that, perhaps a week or so. I wouldn't be able to tell you exactly.

Q. Were those meetings at the request of Mr. Lusthaus?

A. Well——

[fol. 60] Q. Did he write to you asking that you come down to Uniontown?

A. No; I don't think he did. Perhaps he did. I wouldn't want to say. Mr. Boggs and he were discussing this matter. It had come up again in May of that year and Mr. Boggs and he had discussed the matter and it was understood that I was to go down to see him and whether he wrote or we wrote him, I don't know; I couldn't tell you that.

Q. Referring to the meeting of September 19 and the meeting, you say, of September 21——

A. No, September 19. There was one prior to that, too.

Q. September 19, 1939, did you meet with Mr. Lusthaus and Mr. Tenney in Uniontown?

A. Yes. Mr. Boggs and I met with him.

Q. And what was discussed during that meeting?

A. Well, my best recollection is that the meeting that we first had with Mr. Lusthaus—at that meeting we gave him some information concerning the gift taxes and we suggested that he take it up with his accountant and attorneys.

Q. May I interrupt. What was the nature of that information that you gave him?

A. Well, it was just how the gift tax operated with reference to the amount that he could give away and what the taxes were if he wanted to give away more. My best recollection is that Mr. Tenney didn't quite understand the situation as we explained it to Mr. Lusthaus and he made an appointment for us to see Mr. Tenney and discuss the thing with him and this meeting of September 19 was with relation to that.

Q. When you returned to Pittsburgh did you transcribe [fol. 61] the results of your meeting and what was discussed?

A. I dictated a memorandum; yes, sir.

Q. Do you have that memorandum with you?

A. I have the memorandum here.

Q. Using that memorandum as a means of refreshing your recollection, what were the actual conditions that you worked out at that meeting?

A. Well, we explained the way the gift tax and the exclusion worked and then it was understood that Mr. Lusthaus was to consult his attorney and the suggestion was made that he give Mrs. Lusthaus a gift up to at least the extent of the gift tax and then she was to take some of her own money and add to it and buy an interest in his business. That was the——

Q. She was to use the gift that Mr. Lusthaus was going to give her? Under the terms of your suggestion she'd buy into the business?

A. She was to use that and then add some of her own money to it. I think the memorandum states that very clearly.

Q. May I ask you how you arrived at the value of $200,000, and the business was valued at $200,000?

A. I think, perhaps we got that information from Mr. Tenney or Mr. Lusthaus.

Q. Do you know what elements entered into that value?

A. No, I do not, except that we may have had a balance sheet. I don't remember that.

Q. Was Mrs. Lusthaus present at the meeting?

A. At that meeting; no, sir.

Q. Was Mrs. Lusthaus present at any subsequent meeting?

[fol. 62] A. Not that we had with Mr. Lusthaus, that I remember.

Q. Has Mrs. Lusthaus been present at any meeting that you had with Mr. Lusthaus wherein you discussed the partnership agreement or the facts that lead up to the suggestions that you made to Mr. Lusthaus?

A. I think we met Mrs. Lusthaus once or twice in the store and it might have been there that Mr. Lusthaus explained to her the situation. I haven't that very clearly in my mind.

Q. When you explained the situation to Mrs. Lusthaus on these chance meetings in the store, what do you mean by "explained the situation?"

A. Well, he wanted us to explain about it. I think, in the first place, he wanted us to advise her to make a will. I think that he recommended that she do that, and I think that there might have been some questions asked about that. I am not

very clear on that and I shouldn't like to make a statement because I don't remember that.

Q. Mr. Ries, what was the end result to be gained by the formation of the partnership, the gift, and the various other transactions that you advised?

A. Well, when we talked to Mr. Lusthaus we made an analysis of his estate to show him how much ready cash would be necessary to pay off his taxes and the administration of the estate, and we suggested that he divide his estate. Now, that is what we first discussed with him.

Q. You were regarding his estate from a tax viewpoint; is that correct?

A. Yes, sir.

Mr. Wallerstedt: Isn't it a fact that you were trying to sell him insurance?

[fol. 63] The Witness: Yes, sir.

Mr. McFarland: That's all.

Mr. Wallerstedt: Just a minute, please.

Cross-examination.

By Mr. Wallerstedt:

Q. Mr. Ries, did you first call on Mr. Lusthaus, you say back in 1932?

A. Yes, sir.

Q. Your purpose at all times was to have been to sell him insurance?

A. That was the purpose.

Q. And you were then trying to have him set up his affairs in such a way that you could as a selling point for insurance?

A. Well, we were trying to help him set up his estate in the best advantage of his family, and we wanted to sell him insurance in order that there would be enough cash to keep his case liquid.

Mr. McFarland: Respondent rests.

Mr. Wallerstedt: That's all.

(Witness excused.)

* * * Omission from Transcript page 87.

[fol. 64] EXHIBIT No. 1

ARTICLE OF AGREEMENT

Made and entered into this 4th day of June, 1940, by and between Abraham L. Lusthaus and Lillian Lusthaus, both of the City of Uniontown, Fayette County, Pennsylvania, hereinafter sometimes referred to as "Partners", and individually as "Partner."

Whereas, the said Abraham L. Lusthaus has heretofore owned and operated a retail furniture and household furnishings business at 52 West Main Street in the City of Uniontown, Fayette County, Pennsylvania, known as Household Furniture Company, and a similar business at 31 Pittsburgh Street, in the said City of Uniontown, known as Furniture Outlet Store; and

Whereas, by Bill of Sale bearing even date herewith, but effective as of January 1, 1940, Abraham L. Lusthaus has sold and conveyed to the said Lillian Lusthaus an undivided one-half interest in and to said retail furniture and household furnishings businesses; and

Whereas, the parties hereto are now seized as tenants in common, without right of survivorship, of all the property and assets of said business known as Household Furniture Company, and business known as Furniture Outlet Store; and

Whereas, the parties hereto have agreed to engage in the retail furniture and household furnishings business and to operate said stores as Partners under the terms, conditions and provisions hereinafter set forth.

Now Therefore This Agreement Witnesseth, That in consideration of One ($1.00) Dollar in specie by each to the other in hand paid, the receipt whereof is hereby acknowl-
[fol. 65] edged, and in consideration of the mutual covenants and promises hereinafter set forth, the Partners agree to associate themselves as Partners under the firm name and style of "Household Furniture Company", and "Furniture Outlet Store" for the purpose of dealing in furniture, hardware, household equipment, furnishings and other merchandise usually handled by furniture stores, at 52 West Main Street in the City of Uniontown, Fayette County, Pennsylvania, and at 31 Pittsburgh Street in said city, for the term beginning the 1st day of January, 1940, and ending the 1st day of January, 1955, under the terms of

this Agreement of Partnership unless same is terminated by agreement of the parties or by operation of law, viz:

1. All of the assets of the Household Furniture Company and Furniture Outlet Store heretofore owned by the said Abraham L. Lusthaus and which are now owned in equal shares, as tenants in common, by the above named Partners shall constitute the assets of this partnership.

2. It is understood and agreed that the capital of said partnership has a fair value as of January 1, 1940, of Two Hundred Ten Thousand, Five Hundred Seven and 62/100 ($210,507.62) Dollars after allowance made for cash withdrawal in the amount of Twenty Thousand ($20,000.00) Dollars, made by Abraham L. Lusthaus on January 12, 1940, and that each of said Partners have contributed one-half thereof.

3. It is agreed by and between the Partners hereto that they shall share equally in the profits of said partnership and in like manner said Partners shall equally bear and assume the losses of said partnership.

4. Upon the dissolution and liquidation of said partnership, the assets of said partnership at the time of said dis- [fol. 66] solution or liquidation shall be divided or apportioned equally between the Partners according to their respective capital interests or investments in the partnership, as shown by the books of the partnership as of the date of dissolution.

5. The parties hereto agree that during the continuance of said partnership that neither Partner shall, without the consent of the other, enter into any bond or judgment, or become bound as bail or surety, or give any note or accept or endorse any bill of exchange with or for any person or persons whatever, other than the Partner, in any sum or sums in excess of One Thousand ($1,000.00) Dollars in the aggregate, without the written consent of the other partner.

6. It is understood and agreed that the said Abraham L. Lusthaus shall have full charge of the operation of all of the business of said partnership and shall act as Manager thereof, with full power to employ and discharge such persons as he may think advisable and necessary in the proper conduct of said business. In all matters in connection with

the operation and management of said business the said Abraham L. Lusthaus shall be in full control and shall have the final decision.

7. There shall be had and kept during the continuance of the partnership just and true book accounts in which shall be set down in detail all matters and things that shall in any wise appertain to the business of the partnership, and each of the Partners shall at all times have free access thereto.

8. On the last day of each calendar year a general account or a statement shall be taken of all the assets and liabilities of the partnership, and of all dealings and transactions thereof during said calendar year as well as all [fol. 67] other matters and things which are usually included in accounts of like nature. In taking and preparing such statement or account, a just valuation shall be made of all items requiring valuation; merchandise shall be valued at cost or market value, whichever is lower; all leases and other receivables shall be valued at face amount less payments thereon, and all accounts, properly deemed by the said Abraham L. Lusthaus to be worthless shall be eliminated. No good will or other intangibles of any kind shall be included as an asset. Such account shall be entered in a book kept for that purpose, shall be signed by each of said Partners and when so signed shall be binding upon them, their heirs, representatives and assigns. The profits arising from the business as determined by such account shall immediately thereafter be entered on the books of the partnership and credited equally to the respective accounts of the said Partners. Said profits shall bear no interest. Profits may be withdrawn by the Partners at such times as both partners agree that said withdrawals may be made without injury to the welfare and expansion of the partnership business.

9. Under no circumstances shall one of the Partners sell or assign his interest or share in said partnership, or any part thereof, or in any manner pledge or encumber the same to any person or persons whomsoever, without the consent of the other Partner first obtained in writing. Any such assignment, sale, pledge or encumbrance made without the consent of the Partner shall constitute a breach of this agreement, and, at the option of the other Partner, shall ipso facto dissolve the partnership.

10. It is understood and agreed by and between the Partners that in case of the death of one of the Partners, [fol. 68] the surviving Partner shall, within thirty days thereafter, purchase the entire interest in the partnership of the Partner so dying for the price or sum of One Hundred Thousand ($100,000.00) Dollars to be paid within three years from the date of the death of the deceased Partner, with interest on said purchase price at the rate of 3% per annum until paid. In making this agreement the parties hereto intend that it shall constitute an absolute obligation on the part of the estate and personal representative of the Partner so dying to sell his interest to the surviving Partner for the price or sum above mentioned, and an absolute agreement and undertaking on the part of the surviving Partner to purchase the interest of the deceased Partner for said above mentioned price or sum, and in making this agreement the parties hereto do so with the full appreciation of the fact that the book value of said business may be substantially greater or substantially less than the consideration above stated.

11. Upon the dissolution of the Partnership a full and general account of the assets, liabilities and transactions of the partnership shall be taken, stated, copied and signed by both Partners; and if all the affairs of the partnership are adjusted and its debts paid and discharged, then, unless the Partners shall otherwise agree, the remaining assets of the partnership, including money, goods, merchandise, fixtures, accounts, and all other partnership property of every kind whatsoever shall be equitably and fairly divided equally between the Partners, and each of said Partners hereby agrees to execute all such instruments in writing as may be necessary for facilitating the collection of all partnership assets and the division thereof among the Partners according to their respective interests as above set forth; [fols. 69-70] as well as all writings which may be necessary for the mutual indemnity and release of the Partners.

12. It is understood and agreed by and between the parties hereto that all the terms, provisions and conditions of this Partnership Agreement shall be binding upon the said parties, their heirs, executors, administrators and assigns and every of them.

In Witness Whereof, the parties hereto have subscribed their names and attached their seals to this Agreement,

which has been executed in two counterparts, each of which shall be taken to be an original, the day and year first above written.

Signed, sealed and delivered in the presence of A. L. Lusthaus, Lillian Lusthaus. (Seal.)

Jos. W. Ray, Jr.
Bertha M. Radtke

COMMONWEALTH OF PENNSYLVANIA,
County of Fayette, ss:

On this 4th day of June, A. D. 1940, before me, a Notary Public in and for said state and county, personally came the above named Abraham L. Lusthaus and Lillian Lusthaus, parties to the foregoing Agreement, and acknowledged said Agreement to be their act and deed, and desired the same to be recorded as such.

Witness my hand and Notarial seal the day and year aforesaid.

Bertha M. Radtke, Notary Public. (Seal.) My commission expires March 7, 1941.

(Here follow 2 photolithographs, side folios 71-72, 73-74.)

FORM 1065
Treasury Department
Internal Revenue Service

UNITED STATES

Page 1

PARTNERSHIP RETURN OF INCOME 1940

(To be Filed Also by Syndicates, Pools, Joint Ventures, Etc.)

Do Not Use This Space
(Auditor's Stamp)

For Calendar Year 1940

or fiscal year beginning ....., 1940, and ended ....., 1941
(File this return not later than the 15th day of the 3d month following the close of the taxable year)

(PRINT PLAINLY NAME AND BUSINESS ADDRESS OF THE ORGANIZATION)

HOUSEHOLD FURNITURE COMPANY
(Name)

52 EAST MAIN STREET
(Street and number)

UNIONTOWN FAYETTE PENNSYLVANIA
(Post office) (County) (State)

Business or Profession Household Furnishings

Do Not Use These Spaces

File Code .....

Serial No. 978611

District .....
(Date Received)

RECEIVED
Collector of Internal Revenue
PITTSBURGH, PA.
APR 30 1941

Item and Instruction No.	GROSS INCOME				
1.	Gross receipts from business or profession			$ 276,325	62
2.	Less cost of goods sold:				
	(a) Inventory at beginning of year	$ 37,161	90		
	(b) Merchandise bought for sale	158,932	09		
	(c) Cost of labor, supplies, etc.				
	(d) Total of lines (a), (b), and (c)	$ 196,093	99		
	(e) Less inventory at end of year	50,616	68	145,477	31
3.	Gross profit (or loss) from business or profession (item 1 minus item 2)			$ 130,848	31
4.	Income (or loss) from other partnerships, syndicates, pools, etc. (state separately name, address, and amount):				
5.	Interest on bank deposits, notes, corporation bonds, etc. (except interest to be reported in item 6)			15,489	35
6.	Interest on tax-free covenant bonds upon which a Federal income tax was paid at source				
7.	Interest on Government obligations, etc. (From line (d), Schedule A)				
8.	Rents				
9.	Royalties				
10.	Net gain (or loss) from sale or exchange of property other than capital assets (from Schedule B)				
11.	[illegible] Bad Debts previous year collected.			23,960	02
12.	Other income (state nature of income): Purchase Discounts			3,346	07
13.	Total income in items 3 to 12 (enter ascertainable income in Schedules A and C)				$ 173,643 75

HOUSEHOLD FURNITURE COMPANY
(Name)

52 EAST MAIN STREET
(Street and number)

UNIONTOWN FAYETTE PENNSYLVANIA
(Post office) (County) (State)

Business or Profession Household Furnishings

(Gross Receipts)

RECEIVED
Collector of Internal Revenue
PITTSBURGH, PA.
APR 30 1941

CASHIER'S COPY

Item and Instruction No.	GROSS INCOME					
1.	Gross receipts from business or profession			$ 376,325	62	
2.	Less cost of goods sold:					
	(a) Inventory at beginning of year	$ 37,161	90			
	(b) Merchandise bought for sale	158,932	09			
	(c) Cost of labor, supplies, etc.					
	(d) Total of lines (a), (b), and (c)	$ 196,093	99			
	(e) Less inventory at end of year	50,616	68	145,477	31	
3.	Gross profit (or loss) from business or profession (item 1 minus item 2)			$ 130,848	31	
4.	Income (or loss) from other partnerships, syndicates, pools, etc. (state separately name, address, and amount):					
5.	Interest on bank deposits, notes, corporation bonds, etc. (except interest to be reported in item 6)			15,489	35	
6.	Interest on tax-free covenant bonds upon which a Federal income tax was paid at source					
7.	Interest on Government obligations, etc. (from line (d), Schedule A)					
8.	Rents					
9.	Royalties					
10.	Net gain (or loss) from sale or exchange of property other than capital assets (from Schedule B)					
11.	DIVIDENDS Bad Debts previous year collected.			23,960	02	
12.	Other income (state nature of income) Purchase Discounts			3,346	07	
13.	Total income in items 3 to 12 (enter ascertainable income in Schedules A and C)					$ 173,643 75
	DEDUCTIONS					
14.	Salaries and wages (do not include compensation for partners)			$ 42,372	17	
15.	Rent			11,265	00	
16.	Repairs					
17.	Interest on indebtedness (explain in Schedule F)			148	67	
18.	Taxes (explain in Schedule C)			2,640	98	
19.	Losses by fire, storm, shipwreck, or other casualty, or theft (submit schedule, see Instruction 19)					
20.	Bad debts (explain in Schedule D)			8,845	95	
21.	Depreciation (explain in Schedule E)			1,138	68	
22.	Depletion of mines, oil and gas wells, timber, etc. (submit schedule, see Instruction 22)					
23.	Other deductions authorized by law (explain in Schedule F)			26,952	10	
24.	Total deductions in items 14 to 23					93,363 55
25.	Ordinary net income (item 13 minus item 24)					$ 80,280 20
26.	Net short-term capital gain (or loss) (from line 1, column 4, Summary, Schedule H)					$
27.	Net long-term capital gain (or loss) (from line 2, column 4, Summary, Schedule H)					$

NOTE.—In order that this return may be accepted as meeting the requirements of the Internal Revenue Code, the data called for herein must be set forth FULLY and CLEARLY.

71-72

Exhibit No. 3. (Page 1.)

Schedule J.—PARTNERS' SHARES OF INCOME AND CREDITS. (See Instructions 28)

(a) (b) (c) (d) (e) (f) (g)	1. Name and address of each partner (Indicate corporations others). Where ownership of partners or members is filed in another collection district, specify district. If the full share of any partner was not divulged to the business, the percentage of share divulged must be stated	2. Ordinary net income (or loss) (Page 2, line 27, page 1, Schedule K, Column 2, line 12, page 1)		3. Net short-term gain (or loss) from sale or exchange of capital assets (From Schedule H, Summary, line 1, column 6)		4. Net long-term gain (or loss) from sale or exchange of capital assets (From Schedule H, Summary, line 2, column 6)	
(a)	A. L. Lusthaus	$ 40,140	10	$		$	
(b)	Lillian C. Lusthaus	40,140	10				
	Totals	$ 80,280	20	$		$	

CONTINUATION OF SCHEDULE J

(a) (b) (c) (d) (e) (f) (g)	5. Use letters in column (a) to identify partners	6. Wholly tax-exempt obligations (Sec. 22 (b) (4) and (5) of Revenue Act) (Schedule A)		Partially tax-exempt: 7. United States Savings Bonds and Treasury bonds (Sec. 22 (b) (4) Schedule A)		8. Obligations of certain instrumentalities of the United States (Sec. 22 (b) (5) Schedule A)		9. Earned income	10. Charitable contributions (From Schedule B)	11. Federal income taxes paid or accrued (See item 4, page 1)	12. Income and profits taxes paid to a foreign country or United States possession
		Principal	Interest	Principal	Interest	Principal	Interest				
(a)		$	$	$	$	$	$	$ 8,028 05	$ 568 00	$	$
(b)								8,028 05	568 00		
Totals		$	$	$	$	$	$	$ 16,056 10	$ 1135 99	$	$

QUESTIONS

1. Date of organization January 1, 1940
2. Nature of organization (partnership, syndicate, pool, joint venture, etc.) Partnership
3. Was a return filed for preceding year? No If so, to which collector's office was it sent?
4. Check whether this return was prepared on the cash ☐ or accrual ☒ basis.
5. State whether inventories at the beginning and end of the taxable year were valued at (a) cost, or (b) cost or market, whichever is lower Cost

   If any other basis is used, attach statement describing basis fully, state why used and the date inventory was last reconciled with stock
6. Did the organization at any time during the taxable year own directly or indirectly any stock of a foreign corporation or a personal holding company, as defined in section 501 of the Internal Revenue Code? (Answer "Yes" or "No") No

   If answer is "Yes," attach schedule required by Instruction I.
7. Was return of information on Forms 1096 and 1099 filed for the calendar year 1940? (See Instruction H) Yes

5. (a) Enter letter identifying partner	6. Wholly tax-exempt obligations (Sec. 22 (b) (4) and (5) of Schedule A)		7. Partially tax-exempt: United States Savings Bonds and Treasury Bonds (Sec. 22 (b) (4), Schedule A)		8. Obligations of certain instrumentalities of the United States (Sec. 22 (b) (5), Schedule A)		9. Earned income	10. Charitable contributions (From Schedule b)	11. Federal income taxes paid or accrued (For explanation of basis, see page 3)	12. Income and profits taxes paid to a foreign country or United States possession
	Principal	Income	Principal	Income	Principal	Income				
(a)	$	$	$	$	$	$	$ 8,028 05	$ 568 00	$	$
(b)							8,028 05	568 00		
Totals	$	$	$	$	$	$	$ 16,056 10	$ 1135 99	$	$

QUESTIONS

1. Date of organization January 1, 1940
2. Nature of organization (partnership, syndicate, pool, joint venture, etc.) Partnership
3. Was a return filed for preceding year? No. If so, to which collector's office was it sent?
4. Check whether this return was prepared on the cash ☐ or accrual ☒ basis.
5. State whether inventories at the beginning and end of the taxable year were valued at (a) cost, or (b) cost or market, whichever is lower Cost

If any other basis is used, attach statement describing basis fully, state why used and the date inventory was last reconciled with stock

6. Did the organization at any time during the taxable year own directly or indirectly any stock of a foreign corporation or a personal holding company, as defined in section 501 of the Internal Revenue Code? (Answer "Yes" or "No") No
If answer is "Yes," attach schedule required by Instruction I.
7. Was return of information on Forms 1096 and 1099 filed for the calendar year 1940? (See Instruction H) Yes

AFFIDAVIT (See Instruction D)

I swear (or affirm) that this return (including any accompanying schedules and statements) has been examined by me, and to the best of my knowledge and belief is a true, correct, and complete return, made in good faith, for the accounting period stated, pursuant to the Internal Revenue Code and the regulations issued under authority thereof.

Subscribed and sworn to before me this 30th day of April, 1941

A. L. Lauckhaus
(Signature of taxpayer or member)

Carl B. Langford Notary Public
(Signature and title of officer administering oath) My Commission expires Jan. 7, 1945

(Address of partner or member)

(If this return was prepared for you by some other person, the following affidavit must be executed)

AFFIDAVIT (See Instruction D)

I/we swear (or affirm) that I/we prepared this return for the organization named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the income of the person for whom this return has been prepared of which I/we have any knowledge.

Subscribed and sworn to before me this

(Signature of person preparing the return)

(Address of person preparing the return)

TERRY AND COMPANY
(Name of firm or employer, if any)

30th day of April, 1941

Carl B. Langford Notary Public
(Signature and title of officer administering oath) My Commission expires Jan. 7, 1945

16—17871

73-74

Exhibit No. 3.
(Page 4.)

5218

[fol. 75] EXHIBIT No. 4

Know All Men by These Presents, That I, Abraham L. Lusthaus of the City of Uniontown, Fayette County, Pennsylvania, for and in consideration of the sum of One Hundred Five Thousand, Two Hundred Fifty-three and 81/100 ($105,253.81) Dollars paid in the manner hereinafter set forth, the receipt whereof is hereby acknowledged, do hereby grant, bargain, sell, transfer and deliver unto Lillian Lusthaus of the said City of Uniontown, all the following property, to-wit:

The undivided one-half interest in the stock of merchandise, trucks, delivery equipment, office furniture and all other property, including merchandise in transit or stored in any warehouse, comprising the business now owned and operated by me at 52 West Main Street in the City of Uniontown, Pennsylvania, under the trade name Household Furniture Company, and the similar business now owned and operated by me at 31 Pittsburgh Street in the said City of Uniontown, under the trade name Furniture Outlet Store, also an undivided one-half interest in and to all all accounts receivable, bailment leases and other evidences of indebtedness now owing to me as the owner of said businesses.

The property, merchandise rights, credits, etc. above mentioned are sold subject to the payment by the said Lillian Lusthaus of one-half of all debts and liabilities of said businesses, including bills payable, rent, taxes and other liabilities as shown by the books of account of said businesses and as determined by Ross C. Tenney, Public Accountant of the City of Uniontown, said county and state, who is now acting as Auditor and Accountant for said businesses.

[fol. 76] The consideration hereinabove mentioned, to-wit, the sum of One Hundred Five Thousand, Two Hundred Fifty-three and 81/100 ($105,253.81) Dollars has been paid by the said Lillian Lusthaus in the following manner, to-wit, the sum of Fifty Thousand, Two Hundred Fifty-three and 81/100 ($50,253.81) Dollars cash in hand paid, upon the signing of this Bill of Sale, the receipt of which is hereby acknowledged, and the sum of Fifty-five Thousand ($55,000.00) Dollars in eleven (11) promissory notes of said Lillian Lusthaus of Five Thousand ($5,000.00) Dollars each, payable in one, two, three, four, five, six, seven, eight, nine,

ten and eleven years after date, respectively, and bearing interest at the rate of 3% per annum payable annually. The parties hereto declare and agree that the above mentioned consideration represents the full, fair value of the property and interest hereby conveyed as is set forth in financial statement of said businesses, prepared by Ross C. Tenney, Accountant, which is hereto attached, marked Exhibit "A" and made a part hereof. Said statement of the condition of said businesses is prepared as of December 31, 1939, except that the net worth or value of said businesses is reduced Twenty Thousand ($20,000.00) Dollars, being the amount of cash withdrawal made by said Abraham L. Lusthaus on January 12, 1940.

I, Abraham L. Lusthaus, hereby agree that the property and interest hereby sold and conveyed to the said Lillian Lusthaus shall constitute a part of her own separate estate and that from and after the execution of this Bill of Sale the said property and assets of said Household Furniture Company and said Furniture Outlet Store shall be owned by me and the said Lillian Lusthaus, as tenants in common [fol. 77] and not as joint tenants and not as tenants by entireties. It is the intention and agreement of Abraham L. Lusthaus in executing this Bill of Sale and in like manner it is the intention and agreement of Lillian Lusthaus in paying the consideration above mentioned and accepting delivery of this Bill of Sale that they shall own the assets of said retail furniture businesses as tenants in common and that upon the death of the said Abraham L. Lusthaus his undivided interest shall be an asset of his estate, and that, in like manner, upon the death of Lillian Lusthaus her undivided interest shall be an asset of her estate, without any rights of survivorship and in the same manner as if the said Abraham L. Lusthaus and the said Lillian Lusthaus were not married.

To Have and To Hold all and singular the goods and chattels hereinabove described to the said Lillian Lusthaus, her heirs and assigns to her own use and behoof forever. And the said Abraham L. Lusthaus hereby covenants with the said Lillian Lusthaus that he is the lawful owner of said goods and chattels and that they are free from all encumbrances, except as may be shown and indicated on his books of account; that he has the right to sell said goods and chattels and that he will warrant and defend the same against the lawful claims and demands of all persons.

This Bill of Sale and the transfer of ownership of said property, although executed the day and year hereinafter mentioned, shall be effective as of January 1, 1940, the parties hereto having actually agreed to said conveyance on or prior to that date.

[fol. 78] In Witness Whereof, the parties to this Bill of Sale have hereunto set their hands and seals the 4th day of June A. D. 1940.

A. L. Lusthaus, Lillian Lusthaus (Seal).

Witness: Jos. W. Ray, Jr., Bertha M. Radtke.

EXHIBIT "A" TO FOREGOING EXHIBIT

Household Furniture Company, Balance Sheet, December 31, 1939

Tenney and Company, Accountants and Auditors, Second National Bank Bldg., Uniontown, Pa.

Household Furniture Company Balance Sheet, December 31, 1939

Current Assets		
Cash	1,705.92	
Leases Receivable	195,161.01	
Merchandise Inventory	37,161.90	
Total Current Assets		234,028.83
Fixed Assets		
Delivery Equipment	5,705.12	
Office Equipment	3,417.45	
	9,122.57	
Less: Reserve for Depreciation	6,272.52	
Total Fixed Assets		2,850.05
[fol. 79] Deferred Charges		
Prepaid Insurance		455.61
		237,334.49

Liabilities and Capital

Liabilities		
Accounts Payable	17,431.38	
Accrued Liabilities	607.90	
Total Liabilities		18,039.28
Deferred Credits		
Realizable Profit		8,787.59
Capital		
A. L. Lusthaus, Investment		210,507.62
		237,334.49

Tenney and Company.

EXHIBIT No. 6

$5,000.00 January 1, 1940.

One Year after date I promise to pay to the order of Abraham L. Lusthaus Five Thousand ($5,000.00) Dollars Without defalcation, value received with interest at 3% per annum, payable annually.

And further, I do hereby empower any Attorney of any Court of Record within the United States or elsewhere to appear for me and after one or more declarations filed, confess judgment against me as of any term for the above sum with Costs of suit and Attorney's com- [fol. 80] mission of five per cent for collection and release of all errors, and without stay of execution and inquisition and extension upon any levy on real estate is hereby waived, and condemnation agreed to and the exemption of personal property from levy and sale on any execution hereon, is also hereby expressly waived, and no benefit of exemption be claimed under and by virtue of any exemption law now in force or which may be hereafter passed.

This note is one of a series of eleven notes in like amount, payable from one to eleven years after date, respectively, given by the maker to the above named payee, and in case default shall be made in the payment of the principal or interest due on the above note, then at the option of payee,

his heirs or assigns, all of said eleven notes shall forthwith become due and payable.

Witness my hand and seal.

Lillian Lusthaus (Seal).

Witness: Jos. W. Ray, Jr.

Stamped: Paid, A. L. L.

EXHIBIT No. 9

Household Furniture Company Balance Sheet, January 1, 1940

Assets

Current Assets		
Cash	21,705.92	
Leases Receivable	195,161.01	
Merchandise Inventory	37,161.90	
Total Current Assets		254,028.83
[fol. 81] Fixed Assets		
Delivery Equipment	5,705.12	
Office Equipment	3,417.45	
	9,122.57	
Less: Reserve for Depreciation	6,272.52	
Total Fixed Assets		2,850.05
Deferred Charges		
Prepaid Insurance		455.61
		257,334.49

Liabilities and Capital

Liabilities		
Accounts Payable	17,431.38	
Accrued Liabilities	607.90	
Advances by Partners	20,000.00	
Total Liabilities		38,039.28

Deferred Credits		
Realizable Profit		8,787.39
Capital		
A. L. Lusthaus, Investment	105,253.81	
L. C. Lusthaus, Investment	105,253.81	
Net Worth		210,507.62
		257,334.49

[fol. 82] EXHIBIT No. 11

Household Furniture Company

Balance Sheet

December 31, 1940

Assets

Current Assets		
Cash	23,278.12	
Leases Receivable	228,240.72	
Accounts Receivable	420.00	
Merchandise Inventory	50,616.68	
Total Current Assets		302,555.52
Fixed Assets		
Delivery Equipment	5,962.50	
Office Equipment	3,517.45	
	9,479.95	
Less: Reserve for Depreciation	5,328.58	
Total Fixed Assets		4,151.37
Deferred Charges		
Prepaid Insurance		516.23
		307,223.12

Liabilities and Capital

Liabilities		
Accounts Payable	20,594.61	
Accrued Liabilities	653.46	
Total Liabilities		21,248.07

[fol. 83] Capital

A. L. Lusthaus, Investment	140,714.94	
L. C. Lusthaus, Investment	145,260.11	
Net Worth		285,975.05
		307,223.12

EXHIBIT No. 15

Household Furniture Company

Analysis of Investment Accounts

January 1, 1940 to December 31, 1941

A. L. Lusthaus—Investment—January 1, 1940		105,253.81
Add: Profit for year 1940		35,672.10
Add: Transfer of Deferred Income		4,393.79
		145,319.70
Less: Withdrawals—1940		4,604.76
A. L. Lusthaus—Investment—December 31, 1940		140,714.94
Add: Profit for year 1941		31,871.98
Add: Bad Debts disallowed by Revenue Agent (1940)		1,501.20
		174,088.12
Less: Withdrawals—1941		19,198.69
A. L. Lusthaus—Investment—December 31, 1941		154,889.43

[fol. 84] L. C. Lusthaus—Investment—January 1, 1940 105,253.81

Add: Profit for year 1940		35,672.11
Add: Transfer of Deferred Income		4,393.80
		145,319.72
Less: Withdrawals—1940		59.61

L. C. Lusthaus—Investment—December 31, 1940	145,260.11
Add: Profit for year 1941	31,871.97
Add: Bad Debts disallowed by Revenue Agent (1940)	1,501.20
	178,633.28
Less: Withdrawals—1941	16,317.86
L. C. Lusthaus—Investments—December 31, 1941	162,315.42

* Transfer to investment accounts the Realizable Profit on Sales which was included in income of 1936 and 1938 by revenue agent in report dated October 14, 1940.

Exhibit No. 16

Household Furniture Company

Analysis of Withdrawals

January 1, 1940 to December 31, 1941

A. L. Lusthaus

1940

Cash Withdrawals		17,767.56
West Penn Power Company	68.38	
Donations	45.00	
Bell Telephone Company	68.80	
Fayette County Gas Company	780.10	

[fol. 85]

Uniontown Water Company	32.17
Doctors	178.00
Kaufman's, Gimbels, Hornes, etc.	289.09
Subscriptions	11.00

Collector of Internal Revenue	5,268.66	
Personal Insurance	96.00	
		6,837.20
		24,604.76
Less: Cash Advances by Partner		20,000.00
		4,604.76
1941		
Cash Withdrawals		9,157.50
Life Insurance	2,628.27	
Fayette County Gas Company	70.10	
West Penn Power Company	45.58	
Bell Telephone Company	53.37	
Donations	386.41	
Doctors	98.00	
Kaufman's, Gimbels, Hornes, etc.	55.32	
Other Insurance	182.64	
Collector of Internal Revenue	6,499.65	
City Treasurer	8.32	
County Treasurer	13.53	
		10,041.19
		19,198.69

[fol. 86] L. C. Lusthaus

1940		
Collector of Internal Revenue		59.61
1941		
Cash Withdrawals		8,907.50
Collector of Internal Revenue	7,115.04	
City Treasurer	254.82	
Donations	40.50	7,410.36
		16,317.86

IN THE TAX COURT OF THE UNITED STATES

Docket No. 112702

A. L. LUSTHAUS, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Findings of Fact and Opinion—Promulgated March 29, 1944

Husband and Wife Partnership.—Petitioner entered into a partnership agreement with his wife in 1940 purporting to make her an equal partner in a furniture business which he had operated for a number of years. He gave her $50,000 which she immediately returned to him with her promissory notes for $55,000, and a negligible amount of her own funds, in payment of her one-half interest. Thereafter, she contributed no additional capital and rendered only casual services to the business, as she had always done. *Held,* that all of the profits of the business are taxable to petitioner as his individual earnings.

[fol. 87] W. A. Seifert, Esq., William Wallace Booth, Esq., Jos. W. Ray, Jr., Esq., Paul E. Hutchinson, Esq., and A. G. Wallerstedt, C. P. A., for the petitioner. W. J. McFarland, Esq., for the respondent.

The respondent has determined an income tax deficiency of $22,419.98 for 1940. The principal amount, and contested portion, of the deficiency results from the inclusion in petitioner's gross income of all of the profits of a furniture business which petitioner and his wife reported in equal shares as partnership income.

FINDINGS OF FACT

Petitioner is a resident of Uniontown, Pennsylvania. He filed his income tax return for 1940 with the collector of internal revenue for the twenty-third district of Pennsylvania.

For several years prior to 1940 petitioner operated as a sole proprietorship a retail furniture business at Uniontown, Pennsylvania. There were two stores, one known as Household Furniture Co. and one as Furniture Outlet Store.

During 1939 petitioner had several conferences with an accountant and an attorney of Uniontown to discuss the matter of making his wife an equal partner in his furniture business. It was decided in the latter part of that year that petitioner would "sell" to his wife a one-half interest in the business and make her an equal partner as of January 1, 1940. Petitioner instructed his accountant to determine the value of the business and make the necessary changes in the books of account and instructed the attorney to prepare the necessary legal papers.

[fol. 88] The net worth of the business, based on book value of all physical assets and inventory but not including good will, was determined to be $230,000. It was decided that petitioner would withdraw $20,000 from the business, leaving a net worth of $210,000; that he would make his wife a gift of $50,000 which she would use as part payment for her one-half interest and that for the balance, $55,000, she would give petitioner her promissory notes payable $5,000 annually. Petitioner told his wife of the plan and she agreed to it.

The formalities of the transfer were delayed, first by the illness of petitioner's attorney in December 1939, then by the absence of the attorney while he and his wife were on a visit to Mexico in January and February 1940, and finally by the absence of petitioner and his wife while they were on a visit to Florida in March and April 1940. A bill of sale was executed by petitioner on June 4, 1940, conveying to his wife a one-half undivided interest in his furniture business for a stated consideration of $105,253.81 which represented one-half of the estimated value of the business at December 31, 1939. A partnership agreement was executed by petitioner's wife on June 4, 1940. A few days later petitioner borrowed $25,000 from the bank and gave his wife a check for $50,000. This check was drawn against the funds previously withdrawn from the business and those borrowed from the bank. Petitioner's wife then gave petitioner her check dated June 18, 1940, for $50,253.81. She also executed and delivered to him eleven promissory notes for $55,000, as previously agreed upon, in payment of the balance of the purchase price for her interest in the partnership. At that time petitioner's wife owned her home valued at $25,000 or $30,000 and about $20,000 or $25,000 of securities. A certificate authorizing petitioner and his [fol. 89] wife to carry on business under the fictitious name

of Household Furniture Co. was issued by the Commonwealth of Pennsylvania on July 31, 1940.

Petitioner filed a gift tax return for 1940 in which he reported a gift to his wife of $50,000 on January 1, 1940.

Petitioner's furniture business was conducted in substantially the same manner after the consummation of the partnership arrangements as before. Petitioner continued to manage the business, as he was authorized to do under the partnership agreement. His wife helped out at the stores—or one of them—whenever she was needed just as she had always done. She took no active part in the management of the business. She never received any compensation for her services.

Prior to 1940 petitioner and his wife maintained a joint bank account. Some time in 1940 they opened separate accounts. A separate account was maintained for the business in the name of Household Furniture Co. During 1940 petitioner withdrew $4,604.76 from the business and his wife withdrew $59.61. In 1941 petitioner withdrew $19,198.69 and his wife $16,317.86. At the close of each year the profits of the business were credited in the books to petitioner and his wife equally.

A partnership return was filed in the name of Household Furniture Co. for 1940 showing a net profit of $80,280.20. Petitioner and his wife each reported one-half of that amount (less partnership contributions of $1,135.99) in their individual returns for 1940.

Petitioner's wife has paid three of the eleven promissory notes which she gave petitioner under the partnership agreement as they became due.

The respondent determined in his deficiency notice that no bona fide partnership existed between petitioner and his [fol. 90] wife in 1940 and that petitioner is taxable on all of the profits from his furniture business for that year. Those profits, with certain adjustments made in the deficiency notice which are not in controversy, amounted to $84,443.42.

In her individual income tax return for 1940 petitioner's wife claimed all of the personal exemption of $2,000 and petitioner claimed none in his return. Her return shows a gross income of $41,113.12 of which $40,140.10 was partnership income. Petitioner now contends that the entire amount of the personal exemption of $2,000 should be allowed to him instead of to his wife.

OPINION

SMITH, Judge:

We think that the respondent has correctly determined that petitioner is taxable on all of the profits from his furniture business in 1940. The evidence here discloses another of those superficial arrangements whereby a husband undertakes to make his wife a partner in his business for the obvious, if not the sole, purpose of reducing his income taxes.

The picture here is plainly drawn for us. About 1939 petitioner found himself confronted with the prospect of large earnings from his furniture business and the certainty of large income taxes. The matter of the taxes caused him concern. In his travail he sought the help of his accountant. Together they evolved the plan for the husband and wife partnership. Petitioner would "sell" to his wife a one-half interest in the business. He would make her a "gift" of a part of the purchase price and take her promissory notes for the balance. She could pay off the notes from her share of her profits of the business. He could raise the [fol. 91] money for the gift to her by withdrawing some of the surplus cash from the business and borrowing the balance from the bank. He could repay the bank out of her payments on the notes and his share of the partnership profits. An attorney was engaged to look after the legal phases of the plan. Finally, the partnership emerged from the metamorphosis clothed in the outer garment of legal respectability but inwardly perhaps a little uneasy over the flimsiness of its garment of income tax alleviation.

The formalities of executing the partnership agreement and registering the business with the Pennsylvania authorities as a partnership did not change petitioner's economic interests in the business. The wife acquired no separate interest of her own by turning back to petitioner the $50,000 which he had given her conditionally and for that specific purpose. The evidence shows that she had very little to do with the formation of the partnership. She testified that "On the evidence of counsel I did what he told me to do."

On facts similar to those in the present case we denied the existence of a partnership status for income tax purposes between a husband and wife in *Francis Doll*, 2 T. C.

276. Cf. *Francis E. Tower*, 3 T. C. —, promulgated March 3, 1944.

In *Schroder v. Commissioner*, 134 Fed. (2d) 346, the court referred to a comparable factual situation as "another of those efforts to make future returns from personal services taxable to some one other than the real earner of them." The income there resulted largely from the taxpayer's services and abilities as a mechanical and electrical engineer. Here the income resulted largely from petitioner's services and ability as manager of his furniture business and the employment of his capital in the business. [fol. 92] the question of the validity of the partnership under the laws of the state of its creation (Alabama) was not considered important in that case.

Whether or not the arrangement which petitioner made with his wife constituted a valid partnership under the laws of Pennsylvania we do not think it should be given recognition for Federal income tax purposes.

Petitioner now claims the right to the personal exemption of $2,000 which was claimed by his wife in her return for 1940. Apparently he makes this contention in anticipation of an adverse ruling on the question of the right of his wife to report one-half of the profits from his furniture business as partnership income.

We do not think that this claim is timely. The law permits a husband and wife to elect in what proportion they shall claim the personal exemption in their individual returns. Once having made an election they are not free to change their position to better advantage in the light of subsequent developments. There is nothing in this record to indicate that the claim of the personal exemption in the wife's return was due to any mistake or misunderstanding of petitioner's rights in the matter.

Decision will be entered for the respondent.

[fol. 93] IN THE TAX COURT OF THE UNITED STATES, WASHINGTON

Docket No. 112702

A. L. LUSTHAUS, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION—Entered March 29, 1944

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion promulgated March 29, 1944, it is

Ordered and Decided: That there is deficiency in income tax for the calendar year 1940 in the amount of $22,419.98.

Enter: (Signed) Charles P. Smith, Judge. (Seal.)

Entered March 29, 1944.

[fol. 94] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1944

No. 8697

A. L. LUSTHAUS, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the Tax Court of the United States

ORDER ASSIGNING HON. GUY L. FAKE FOR ARGUMENT—Filed December 7, 1944

And now, to-wit: this 7th day of December A. D. 1944, it is ordered that Hon. Guy L. Fake, District Judge, for the District of New Jersey, be, and he is hereby assigned to sit in above case in order to make a full court.

H. F. Goodrich, Circuit Judge.

[File endorsement omitted.]

[fol. 95] In United States Circuit Court of Appeals for the Third Circuit, October Term, 1944

No. 8697

A. L. Lusthaus, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

On Petition for Review of Decision of the Tax Court of the United States

Before Goodrich and McLaughlin, Circuit Judges, and Fake, District Judge

Opinion of the Court—Filed April 11, 1945

By McLaughlin, Circuit Judge:

The question presented is whether the asserted partnership of the taxpayer and his wife should be so recognized for federal income tax purposes. The year involved is 1940.

It is conceded for the petitioner that the facts as found by the Tax Court are substantially correct. Briefly these are: For several years prior to 1940, the petitioner owned and operated a retail furniture business, consisting of two stores, both in Uniontown, Pennsylvania. In 1939 petitioner conferred several times with an accountant and an attorney and it was decided that he would "sell" to his wife a one-half interest in his business and make her an equal partner as of January 1, 1940. The net worth of the business, excluding goodwill and after a withdrawal of $20,000 by peti- [fol. 96] tioner, was determined to be $210,000. Petitioner decided to make a gift to his wife of $50,000 so that she would have it as part of the purchase money for the one-half interest. After some delay, in June, 1940, the petitioner executed a bill of sale to his wife for a one-half undivided interest in his furniture business. The stated consideration was $105,253.81, representing one-half of the estimated value of the business on December 31, 1939. Mrs. Lusthaus, at or about the same time, executed a partnership agreement. A few days later the petitioner borrowed $25,000 from a bank. He gave his wife a check for $50,000 which

sum was made up from the proceeds of the loan and from money previously withdrawn from the business. Then Mrs. Lusthaus gave petitioner her check for $50,253.81 together with eleven promissory notes totalling $55,000, as the purchase price. At that time Mrs. Lusthaus owned her own home valued at $25,000 and at least $20,000 of securities. On July 31, 1940 a certificate authorizing the petitioner and his wife to carry on business under the fictitious name of "Household Furniture Co." was issued by the Commonwealth of Pennsylvania. A gift tax return for 1940 was filed by the petitioner and this reported a gift to his wife of $50,000 on January 1, 1940.

Thereafter the business proceeded in much the same fashion as prior to the partnership transaction. Petitioner, as always, managed the business. Such management was specifically provided for in the partnership agreement. The wife who had assisted in the store, or stores, prior to the partnership arrangement, continued that practice. She received no salary at any time. Prior to 1940 Mr. and Mrs. Lusthaus had maintained a joint bank account. In 1940 they opened separate accounts. There was a third account for [fol. 97] the Household Furniture Co. In 1940 the petitioner withdrew $4,604.76 from the business and the wife withdrew $59.61. In 1941 the petitioner withdrew $19,198.69 and the wife $16,317.86. The profits of the business were credited equally at the close of each year. Mrs. Lusthaus has paid three of the promissory notes. In 1940 a partnership return was filed in the name of "Household Furniture Co." showing a net profit of $80,280.20. Petitioner and his wife each reported one-half of that amount less partnership contributions, etc., in their individual returns for 1940.

On these facts the Tax Court found that the petitioner is taxable on all of the profits from the said furniture business in 1940. That Court said: "The evidence here discloses another of those superficial arrangements whereby a husband undertakes to make his wife a partner in his business for the obvious, if not the sole, purpose of reducing his income taxes."

On behalf of the petitioner it is asserted that the Tax Court erred as a matter of law in so concluding from the facts. It is urged that the facts show a legitimate, operating partnership business under general law and under the Partnership Act of the Commonwealth of Pennsylvania. Even assuming that the arrangement more or less complied

with the formalities of the Pennsylvania law, that would not necessarily be binding for tax purposes. The cases hold that the status must be genuine, with a change in economic interest. Gregory v. Helvering, 293 U. S. 465; Helvering v. Clifford, 309 U. S. 331; Higgins v. Smith, 308 U. S. 473; Griffiths v. Commissioner, 308 U. S. 355. It is well settled that taxation is a practical matter in which substance controls the form. Harrison v. Schaffner, 312 U. S. 579; United States v. Phellis, 257 U. S. 156; Weiss v. Stearn, 265 U. S. 242.

[fol. 98] The one real problem is whether there was substantial evidence to support the Tax Court's conclusion. If there was, then we are not at liberty to re-weigh the evidence or to chose between conflicting inferences. Commissioner of Internal Revenue v. The Scottish American Investment Company, Limited, — U. S. —, filed December 4, 1944; Dobson v. Commissioner, 320 U. S. 489, rehearing denied 321 U. S. 231.

It could be inferred from the evidence that there was no real contribution of capital by Mrs. Lusthaus. The circumstances surrounding the $50,000 incident, with the money immediately returned to the petitioner, could be construed as indicating that the latter had not divested himself irrevocably of the subject matter of the gift. Mrs. Lusthaus' services to the partnership were virtually the same as she had rendered in the stores prior to 1940. The testimony could be taken to indicate that the conduct of the parties with reference to the furniture company did not change. In Earp v. Jones, 131 F. 2d 292 (C. C. A. 10), certiorari denied, 318 U. S. 764, the Court said at page 294:

> "One may not merely change the form but do business in substantially the same way. An essentially new and different economic unit must be formed."

Other evidence not specifically set out in the findings of fact tends to justify the Tax Court's decision. For example, the bank with which the company had its account was not given the right to accept Mrs. Lusthaus as a partner of the concern with authority to draw checks until 1943. The petitioner continued to file social security tax returns as owner of the business through 1940 and up until June of 1941.

As the Supreme Court says in its Scottish American [fol. 99] opinion, supra, "Our examination of the record convinces us that the factual inferences and conclusions of the Tax Court are supported by substantial evidence * * *". We cannot say here that the Tax Court's conclusion to the effect that the alleged partnership was not bona fide, is unreasonable. The decision of the Tax Court is, therefore, affirmed.

DISSENTING OPINION

FAKE, District Judge, Dissenting:

This is not the first time a partnership between husband and wife has been dealt with by the Federal Courts as bearing on the payment of income taxes. If, however, there is any one sphere wherein the axiom should be followed that every case must be decided upon its own peculiar facts, it is in this complicated and elusive sphere.

A careful study of the cases cited in the briefs, together with some independent research, fails to disclose any other case wherein the pertinent evidentiary factors of the instant case are all met with. In short, nothing has been found on all fours with the problem here. While it is true that certain basic principles are spelled out in the cases and the rule requiring substantial evidence has become more or less fixed, much is yet to be desired before the lower courts can function on the subject with certainty. So also counsel, learned in the law, are placed in the same dilemma in advising their clients on the subject.

The uncontradicted evidence in this case discloses that the petitioner and his wife had given considerable thought to the question of a business partnership between them and endeavored to embark upon such a relationship. To this end petitioner retained counsel familiar with the law and [fol. 100] also a public accountant skilled in the pertinent tax problems and the necessary actuarial factors to be considered. As a result of conferences between the petitioner and his wife and in the light of the advice of the accountant and counsel, the following steps were taken to the end that a partnership might be established:

(1) The value of petitioner's business was ascertained from a statement made up from the books of the business and fixed at $230,507.62, as of January 1, 1940.

(2) On January 12, 1940, petitioner withdraw $20,000 in cash from the business, thus reducing the value of the assets to $210,507.62.

(3) On June 4, 1940, a partnership agreement was entered into between petitioner and his wife taking effect retroactively on January 1, 1940, wherein the value of the assets is fixed at $210,507.62, because of the withdrawal of 20,000 as above mentioned.

(4) On the same day, to wit, June 4, 1940, the petitioner executed and delivered to his wife a bill of sale transferring to her an undivided one-half interest of, in and to the assets of the business in consideration of the sum of $105,253.81.

(5) Petitioner made his wife a present of $50,000, evidenced by his check, to be applied by her to the purchase price above mentioned and paid a gift tax thereon.

(6) The wife gave petitioner her personal check for $50,253.81 to be applied on the purchase price, and executed and delivered to petitioner a series of eleven promissory notes each in the sum of $5,000 payable [fol. 101] in one to eleven years, respectively, thus accounting for the full purchase price, and these notes have been paid as they matured.

(7) The business is that of buying and selling household furniture, carried on in two stores, one known as Household Furniture Company and the other as Furniture Outlet Store, both in Uniontown, Pennsylvania.

(8) Certificates to transact business as partners under these assumed or fictitious names were duly filed in the Office of the Secretary of the Commonwealth and in the Office of the Prothonotary of Fayette County, pursuant to Pennsylvania law.

(9) As of January 1, 1940, partnership books were opened and thereafter the profits of the partnership were equally divided between the partners on the books of the firm, and each partner thereafter made withdrawals therefrom, making deposits in their respective individual accounts.

(10) The wife had a separate estate consisting of a dwelling valued at from $25,000 to $30,000 and secu-

rities valued at from $20,000 to $25,000 before and at the time she entered into the partnership.

(11) Before the wife entered into the partnership she had for years helped out in the stores and after the partnership she functioned in like manner.

(12) The bank with which the partnership had its account was not authorized to accept checks of the wife as a partner until 1943.

[fol. 102] (13) Social Security tax returns were filed after the partnership until 1941, reciting petitioner as owner.

(14) The income tax return for the year 1940 was filed as a partnership return.

(15) The partners instituted law suits in the partnership name.

It is upon the foregoing undisputed cold facts that the Tax Court says: "The evidence here discloses another of those superficial arrangements whereby a husband undertakes to make his wife a partner in his business for the obvious, if not the sole, purpose of reducing his income taxes."

This conclusion constitutes an omnibus generality. It indicates no specific separate evaluation of the fifteen factors involved, and bases the conclusion entirely on inference or motive rather than on the law involved. I do not understand that in all instances where one changes his financial status with relation to his wife for the purpose of reducing his income taxes, he is to have his consummated plans set at naught. The better approach would seem to be one directed to an endeavor to ascertain the legal and equitable effect of the fifteen factors with which we are here concernd.

The opinion of the Tax Court says: "Finally, the partnership emerged from the metamorphosis clothed in the outer garment of legal respectability but inwardly perhaps a little uneasy over the flimsiness of its garment of income tax alleviation." On reading this in the solitude of my chambers, surrounded by row on row of volumes dealing with the hard cold logical realities of life, it is indeed refreshing to find myself entering a mystic realm and dreaming in

unison with the poet Ovid in his Metamorphoses and imagining that dear, sweet thing, Daphne, changed into a [fol. 103] laurel while fleeing from Apollo. But I must snap out of it and reenter that mundane realm wherein a great jurist once said: "The power of tax is the power to destroy." We have here, clearly discernible, an American taxpayer, true to form, apparently inspired by his constitutional rights in the light of early American history. Surely we must respect the sacredness of his rights.

The opinion of the Tax Court holds: "The wife acquired no separate interest of her own by turning back to petitioner the $50,000 which he had given her conditionally and for that specific purpose." This, in my opinion, is a mistake of law. The uncontradicted evidence discloses that she received, under the law of Pennsylvania, a one-half interest in assets of her husband in which she theretofore had no such interest; not only is this evidenced by the articles of partnership, but also by a bill of sale, and still further pointed by the filing of certificates to transact business under assumed partnership names. While it is true that the $50,000 gift was tied to the specific use to which it was to be put, it is noted on analysis that this amounts to the same thing as a gift of an undivided interest in the assets of the business to the extent of $50,000. The assets had been valued at a sum certain. A gift tax had to be paid on that part of the consideration which was represented by the gift; hence, the check is for a sum certain to make a full disclosure and to keep the record straight for gift tax purposes. I am quite unable to find any evidence in the case from which a different conclusion can be arrived at.

The Tax Court holds: "The formalities of executing the partnership agreement and registering the business with the Pennsylvania authorities as a partnership did not [fol. 104] change petitioner's economic interests in the business." This appears to me to be a conclusion of law in direct conflict with the statutory and case law of Pennsylvania. It is arrived at arbitrarily and wholly without evidence upon which such a conclusion may be drawn. Moreover, it seems to me it is certain under the Pennsylvania law that when petitioner's wife entered the partnership, she brought with her additional capital beyond that mentioned in the partnership agreement. Her separate estate as mentioned in the tenth fact above would be liable for the firm debts on a marshalling of the assets in the event

of insolvency. This in effect strengthened the position of the petitioner and weakened that of his wife.

Under the law of Pennsylvania the petitioner and his wife as well have certainly changed their economic interest in the business. The articles of partnership and the bill of sale, emphatically and without ambiguity, accomplish very material changes. Both petitioner and his wife were solvent at the time; there is no fraud, actual or constructive; petitioner has come into court with clean hands and has made a full and complete disclosure. Therefore the articles of partnership, the bill of sale and the certificates mean exactly what they say. I must admit however that petitioner sought, among other things, a legal status which would result in a reduction of his taxes. But this he had a perfect right to do.

Thus far emphasis has been placed on the Pennsylvania law. This emphasis is occasioned by Poe v. Seaborn, 282 U. S. 101, wherein it is said, at page 110, "What, then, is the law of Washington as to ownership of community property and of community income, including the earnings of the husband's and wife's labor? The Answer is [fol. 105] found in the statutes of the State, and the decisions interpreting them."

The authority of the state in an analogous field is dealt with in Erie R. Co. v. Tompkins, 304 U. S. 64, at page 78, wherein it is said: "Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State". In this connection, it is my view, that until Congress legislates to define partnership for income tax purposes, we must of necessity resort to the state law for the purpose of ascertaining the existence of that relationship. It has its roots in the common law of the state alone, and Pennsylvania has enacted a Uniform Partnership Act in furtherance of it.

In Poe v. Seaborn, supra, an income tax problem was also before the court and it was held there that: "The District Court was right in holding that the husband and wife were entitled to file separate returns, each treating one-half of the community income as his or her respective income * * *." In 1939, the Supreme Court said in Morgan v. Commissioner, 309 U. S. 78, at page 82: "* * * in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the tax-

payer had in the property or income sought to be reached by the statute."

That there has been no falling away by the Supreme Court from the position taken in Poe v. Seaborn, supra, is apparent as late as 1942. In the case of Helvering v. Stuart, 317 U. S. 154, 161, Mr. Justice Reed says: "When Congress fixes a tax on the possibility of * * * the distribution of income, the 'necessary implication', we think, is that the possibility is to be determined by the state law."

[fol. 106] On the same day the case now before us was argued, we heard the case of Lum v. Commissioner, — F. 2d —, filed January 30, 1945. In that case we considered assignments in New Jersey made by a husband to a wife, which resulted in a tax saving by the husband. There we followed the rule in Poe v. Seaborn, supra, without directly citing it, and said: "The assignments are governed by the law of that state". It is my thought that we must follow the same rule here.

As to the substantial evidence rule which now obtains generally in administrative tribunals where the basic law so permits, and is therefore applied in this case, it is noted that a definition is provided in Edison Co. v. Labor Board, 305 U. S. 197, 229. There Mr. Chief Justice Hughes, speaking for the Court, said: "We agree that the statute, in providing that 'the findings of the Board as to the facts, if supported by evidence, shall be conclusive,' means supported by substantial evidence. * * * Substantial evidence is more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." This is tied in by the Supreme Court in Dobson v. Commissioner, 320 U. S. 489, 501, as follows: "* * * all that we have said of the finality of administrative determination in other fields is applicable to determinations of the Tax Court." Again, in Commissioner v. Scottish American Co., 323 U. S. 119, 124, Mr. Justice Murphy, speaking for an unanimous court, said: "* * * when the Tax Court's factual inferences and conclusions are determinative of compliance with statutory requirements, the appellate courts are limited to a determination of whether they have *any substantial basis in the evidence.*" (Emphasis added.)

[fol. 107] A painstaking reading of the record in this case fails to disclose to my mind any evidence whatever, much

less substantial evidence as above defined, to sustain the conclusion that the petitioner received that income which the law of Pennsylvania vested in his wife. If *earned* income plays a part, it appears that the capital the wife put in was stored up labor and functioned as such in addition to her personal services. The facts set forth in (12) and (13) hereof furnish excellent examples of what Mr. Chief Justice Hughes had in mind when he referred to scintilla evidence as being insufficient to constitute substantial evidence, as quoted above. This in no way conflicts with Norton v. Warner Co., 321 U. S. 565, 568, wherein it is said: "* * * the District Court was not warranted in setting aside such an order because the court would weigh or appraise the evidence differently." Nor is it in conflict with Commissioner v. Scottish American Co., 323 U. S. 119. In identifying scintilla evidence no weighing process is involved since now by decision, the judicial stilliards cannot be adjusted to the weighing of the infinitesimal. It is now merely a matter of identification and this court is still free to identify it and call it by its right name.

In recent years an enormous corpus juris has arisen in what is termed the field of Administrative Law. In the administrative process the right to trial by jury is denied, the rules of evidence based on logic and centuries of experience in Anglo-Saxon jurisprudence are all but ignored, and in appeals, consideration of the facts de novo is prohibited. Thus we have ushered in the continental system in a vast field. The late greatly lamented Lord Chief Justice Hewart of England being concerned with such thoughts took time from the bench to write an illuminating book on [fol. 108] the subject. The title of his book sums up the whole matter as "The New Despotism". Cosmopolitan Book Corp., New York 1929. Yet, in the face of this tremendous foreign onslaught, the courts in equity still function serenely on appeals in the light of the evidence before them with full power to consider the facts de novo, and so also in non jury cases at law. Thus it is seen that in the sphere of administrative law the rights of American citizens, involving their personal liberty and their private property, are being at times manhandled without logic and without heed to the spirit of Anglo-Saxon tradition. Unless the appellate courts intelligently and courageously identify scintilla evidence and cast it out when they do find it, the

Bill of Rights, with its reservations in the States, becomes a mockery to all lovers of liberty. If in the future, perchance, the citizenry of America finds itself in the throes of tyranny, it will not be a satisfactory answer by the guardians of liberty, the courts, to say then, that the "situation did not warrant a great expenditure of appellate court energy on unraveling conflicting factual inferences" as is said in Commissioner v. Scottish American Co., supra.

There is a branch of the law of evidence to be considered which has not as yet been stricken down. The Tax Court has found as an ultimate fact that the petitioner theoretically is in receipt of an income, which on the uncontradicted evidence he never did receive. This is arrived at of course by the injection of inferences. The vice of this is that we find inferences founded on inferences. In dealing with this subject, Wigmore on Evidence, 3rd Edition, Sec. 41, approves New York Life Ins. Co. v. McNeely, — Ariz. —, 79 Pac. 2nd 948, wherein it is said: "* * * the prior inferences must be established to the exclusion of any other reasonable theory rather than merely by a probability, in [fol. 109] order that the last inference of the *probability* of the ultimate fact may be based thereon." (Emphasis added.) See also, Whealton v. U. S., 113 Fed. 2nd 710, in this Circuit, and U. S. v. Ross, 92 U. S. 281.

For the reasons aforesaid I would reverse the decision of the Tax Court.

A true Copy. Teste:

—— —— Clerk of the United States Circuit Court of Appeals for the Third Circuit.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

And afterwards, to wit, the 7th day of December, 1944, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable Herbert F. Goodrich, and Honorable Gerald McLaughlin, Circuit Judges, and Honorable Guy L. Fake, District Judge, and the Court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 11th day of April, 1945, come the parties aforesaid by their counsel aforesaid, [fol. 110] and the Court, now being fully advised in the premises, renders the following decision:

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1944

No. 8697

A. L. LUSTHAUS, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Present: Goodrich and McLaughlin, Circuit Judges, and Fake, District Judge.

Appeal from the Tax Court of the United States

JUDGMENT—Filed April 11, 1945

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Tax Court of the United States in this cause be, and the same is hereby affirmed.

By the Court, Gerald McLaughlin, Circuit Judge.

April 11, 1945.

[File endorsement omitted.]

[fol. 111] IN THE UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

PETITION FOR REHEARING ON PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES

A. L. Lusthaus, petitioner in the above proceeding in which, following oral argument and the submission of printed briefs, your Honorable Court entered its opinion on

April 11, 1945, wherein the decision of the Tax Court of the United States was affirmed, hereby respectfully petitions your Honorable Court, pursuant to Rule 35 of the Rules of the United States Circuit Court of Appeals of the Third Circuit, that the matter be reheard. The grounds relied upon by the petitioner in support of his said petition for rehearing are as follows:

Statement of Points Relied Upon

1. The basic and fundamental premise upon which the Tax Court's decision is grounded is its *legal conclusion* that petitioner's gift of $50,000 to his wife was conditional and therefore no title or interest in the subject matter thereof vested in the wife. This is a mistake of law.

[fol. 112] 2. From such basic premise the Tax Court draws a second legal conclusion, to wit, that the payment of said $50,000 to petitioner by his wife as consideration for the bill of sale transferring to her an undivided one-half interest in his furniture business, did not vest in her any title, interest or ownership of said property. This is a mistake of law.

3. Upon the two false premises above recited the Tax Court then draws the factual conclusion that since petitioner's wife owned nothing by virtue of the gift, she acquired nothing by the bill of sale, which lacked consideration, and, consequently, she made no real contribution to the partnership and it cannot be recognized for tax purposes.

4. Decisions of the Tax Court entered subsequent to the opinion in the instant case and acquiesced in by the Commissioner of Internal Revenue have abandoned as untenable the principle of law that a conditional gift followed by prompt performance of the conditions subsequent is not a completed gift.*

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* *R. P. Scherer v. Commissioner*, 3 T. C. 776 (acq.); *J. D. Johnston, Jr. v. Commissioner*, 3 T. C. 799 (acq.); *M. W. Smith, Jr. v. Commissioner*, 3 T. C. 894 (acq.); also Memorandum Opinion *J. W. Haliwanger*, C. C. H. Dec. 14334M, decided January 18, 1945; all giving complete recognition to the validity of a contribution made by a wife who is actually the owner of the property interest or property contributed.

5. The decision of the United States Circuit Court of Appeals for the Sixth Circuit in the case of *Francis E. Tower v. Commissioner of Internal Revenue*, decided April 2, 1945, is authority for and recognizes the principle of law that a gift *inter vivos* by a husband to his wife is nevertheless valid and complete even though coupled with the condition that the donee shall promptly invest the subject matter of such gift in a designated manner. Such gift vests com- [fol. 113] plete title in the donee, once the condition is extinguished.

6. The recent decision of this Court in the case of *Ralph E. Lum v. Commissioner of Internal Revenue*, decided January 30, 1945, 45-1 U. S. T. C., paragraph 9155, is authority for and recognizes the principle of law that the interpretation of a written document is a question of law and that, where such writing affects property interests or contract rights, it is governed by the law of the state in which the parties reside and the instrument was executed.

7. The decision of this Court in the instant case is in conflict with its decision in the case of *Ralph E. Lum v. Commissioner of Internal Revenue. supra*, as pointed out in the dissenting opinion. It is also in conflict with the decision in the case of *Francis E. Tower, supra.*

8. The decision of the Court in the instant case is erroneous in that the basic finding of the Tax Court is considered as a factual conclusion; whereas such conclusion is not a factual but is a *legal conclusion* and constitutes a clear-cut mistake of law.

Discussion

The majority opinion of the Court entered in this case is grounded upon what petitioner believes to be an erroneous conclusion of law rather than a factual conclusion based upon evidence. Petitioner respectfully submits that both the opinion of the United States Tax Court and the majority opinion entered in this case cannot find support except upon the basic premise that petitioner's wife did not acquire and own the sum of $50,000 received by her as a gift from her husband. If petitioner's wife did not own [fol. 114] the $50,000, it might be inferred that she had nothing to give and that she gave no consideration for the transfer to her of an undivided interest in her husband's

furniture business, that she made no actual contribution to the partnership. If, on the other hand, petitioner's wife *did in fact receive and in law became the owner of $50,000 by valid gift*, and if thereafter she invested her $50,000 and acquired ownership of an interest in the furniture business theretofore conducted by her husband, *the vesting in her of an income-producing asset cannot be ignored under the Pennsylvania law nor under the Federal Income Tax Law.*

Petitioner does not believe it to be the intent of your Honorable Court to hold that where a wife makes an *actual contribution of her own cash* to a business partnership in which capital is an income-producing factor, the income which is the fruit of her capital investment can arbitrarily be considered as taxable to her partner merely because that partner is her husband.

We understand, on the contrary, that the opinion of your Honorable Court is grounded upon the following conclusions accepted as factual and as supported by the evidence:

1. That petitioner's gift of $50,000 to his wife was upon condition that she invest the subject matter thereof in a proposed partnership.

This is a factual conclusion and is correct.

2. That from the presence of such condition attaching to the gift it may be inferred that petitioner retained such "control" that no change in economic interest resulted. The gift was incomplete.

This is a legal and not a factual conclusion and as such is not supported in law.

[fol. 115] 3. That the bill of sale and partnership agreement were ineffective to vest property rights in petitioner's wife since she gave no consideration for the transfer and made no real contribution to the capital of the partnership.

This is a legal and not a factual conclusion. It is reached by the application of incorrect principles of law.

4. That the conveyances to petitioner's wife were superficial and for the obvious if not for the sole purpose of reducing income tax. Consequently the alleged partnership was not bona fide.

This is the "ultimate finding" or conclusion grounded upon the preliminary premises hereinbefore recited.

Petitioner asserts that even if the above conclusions of the Tax Court were factual conclusions, there is no evidence in the record legally sufficient to support them. In this connection the Court's attention is directed to the basic principle that substantial evidence means more than a scintilla of evidence, that it means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. See *Edison Company v. Labor Board*, 305 U. S. 197. This basic test is not changed by the decision of the Supreme Court in *Dobson v. Commissioner*, 320 U. S. 489, nor in the case of *Commissioner v. Scottish American Company*, 323 U. S. 119.

Petitioner contends that in the light of the decision of the United States Circuit Court of Appeals of the Sixth Circuit in the case of *Francis E. Tower v. Commissioner of Internal Revenue*, decided April 2, 1945, the Tax Court's conclusion that no property rights vested in petitioner's wife by virtue of his gift to her is a mistake of law; and further that the Tax Court made a second mistake of law [fol. 116] when it held that the bill of sale of petitioner to his wife effected no change in the economic interests of the parties. The opinion of the Tax Court holds: "The wife acquired no separate interest of her own by turning back to petitioner the $50,000 which he had given her conditionally and for that specific purpose." This statement necessarily involves the validity and completeness of the gift in question. It is a mistake of law. It is also the basic premise upon which the Tax Court's ultimate finding is grounded.

In the *Tower* case, *supra*, which involved the gift of the capital stock of a corporation made by a husband to his wife with the understanding that upon liquidation of the corporation the wife should transfer her interest to a partnership to be formed, Circuit Judge Simons, speaking for the majority, said as follows:

> "The tax judge reasoned that the taxpayer did not relinquish control of the stock transferred to his wife since she could use it in but one way, namely, to place corporate assets, which the stock represented, into the partnership. Because of the condition attached to it, the transfer did not constitute a valid and complete gift of shares. There was no purpose and intent to vest absolute dominion over the shares in the wife,

and since she lacked untrammeled freedom in their disposition, she made no capital contribution to the partnership, and was not a bona fide partner. The conclusion that the transfer was invalid as a gift is rested on the ground that title, dominion, and control of the subject matter were not, *in praesenti*, conveyed. Reliance is chiefly placed on *Edson v. Lucas*, 40 Fed. (2d) 398 (C. C. A. 8), where essential elements of a gift *inter vivos*, are catalogued. In that case, however, [fol. 117] the conditions attached to the gift went far beyond that here involved, including reversion of the subject matter to the donor. Notwithstanding, the gift was sustained, Judge Sanborn, after an exhaustive analysis of cases, arriving at the conclusion that a gift is not invalid because of conditions imposed by the donor which are not inconsistent with the immediate vesting of such legal title in the donee. The case is authority for the validity of a gift, even though coupled with a condition subsequent which doesn't interfere with the vesting of title in the donee. Such was the gift here involved.

"Granted, however, that, because of the condition, Tower's gift was not complete at the time he gave the shares to his wife, the condition was almost immediately performed. The gift was then both valid and complete, vesting title in the wife to the corporation assets contributed by her to the partnership capital. * * *"

In the *Tower* case, *supra*, as in the instant case, the basic conclusion regarding the gift involved rests on the ground that title, dominion and control of the subject matter thereof was not conveyed. Under this decision such basic conclusion is demonstrated as a mistake of law. The corollary and supporting principle of law is that property rights or legal status determined or established pursuant to local law is entitled to recognition for Federal income tax purposes, and can be the subject of taxation only as provided in the tax statutes. See *Helvering v. Stuart*, 317 U. S. 154, 87 L. Ed. 154; *Blair v. Commissioner*, 300 U. S. 5, 9, 81 L. Ed. 465-469; *Freuler v. Helvering*, 291 U. S. 35, 78 L. Ed. 634; *Poe v. Seaborn*, 282 U. S. 101, 110; *Erie R. Co.* [fol. 118] *v. Tompkins*, 304 U. S. 64; *Morgan v. Commis-*

sioner, 309 U. S. 78; in which latter case the Court says, at page 82:

> "In the application of a Federal Revenue Act, state law controls in determining the nature of the legal interest which the taxpayer had in the property or income sought to be reached by the statute."

These principles are fully recognized in the decision of your Honorable Court in the recent case of *Lum v. Commissioner*, filed January 30, 1945, 45-1 U. S. T. C., paragraph 9155. This case involved the legal effect of an assignment of real estate. It was held that the issue involved was not a question of fact but an interpretation of the written document which the Court is free to construe for itself. The opinion states affirmatively that the real estate being located in New Jersey, "the assignments are governed by the law of that state," citing *Blair v. Commissioner, supra.* With respect to the assignment held to be a valid transfer of a property interest, the decision states that the transferee is responsible for income tax on the rent received under lease. This is equivalent to stating that the transferee, being the owner of a property right or interest established under local law, must of necessity be subject to Federal income tax only to the extent and in the manner in which the Federal Internal Revenue Acts make him taxable as the owner of property.

The Tax Court has not made any finding of fact that the gift in question was not valid. The reasoning is that the petitioner retained "control" over the subject matter of the gift by attaching the condition that it be invested in the partnership and that because of this condition subsequent the petitioner's wife owned nothing and consequently could not and did not contribute anything to or acquire a [fol. 119] "separate interest" in the partnership. The principle of law that such gift is complete upon extinguishment of the condition, and vests title in the donee is disregarded.

Petitioner therefore earnestly contends that the actual problem presented in this case was not considered or passed upon in the majority opinion. The real issue is whether or not petitioner's wife became the actual owner of property by gift and/or by a purchase. If she did in fact become the actual owner of property by gift, she admittedly con-

tributed to the capital of the partnership enterprise. Transactions which in law change property rights and economic interest and ownership are in no sense "superficial arrangements." Their reality cannot be questioned.

Wherefore, it is respectfully requested that your Honorable Court grant petitioner a rehearing and reargument in this case so that further full and adequate consideration may be given to the facts herein involved and the principles of law applicable thereto, to the end that the decision of the Tax Court be reversed as grounded upon a mistake of law.

Respectfully submitted, W. A. Seifert, William Wallace Booth, Paul E. Hutchinson.

[fol. 120] CERTIFICATE OF COUNSEL

I, Paul E. Hutchinson, of Counsel for petitioner, do hereby certify that the foregoing petition for rehearing and reargument of the above-entitled case is presented in good faith and not for the purpose of delay, but because petitioner and his counsel believe that petitioner has been unjustly aggrieved by the opinion of the Court.

Paul E. Hutchinson, of Counsel for Petitioner.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS

[Title omitted]

ORDER DENYING PETITION FOR REHEARING—Filed May 28, 1945

And now, to wit May 28th, 1945 after due consideration, the petition for rehearing in the above-entitled case is hereby denied.

Biggs, Circuit Judge.

[File endorsement omitted.]

[fol. 121] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 122] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 8, 1945

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Jackson and Mr. Justice Burton took no part in the consideration or decision of this application.